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Trade-related impacts of the United States presidential election

Introduction

President-elect Trump's ambitious plans for his first 100 days in office include a variety of trade-related actions.[1] At this point, not much detail has been released. In this article, we examine a number of these trade-related proposals.

Border adjustment tax issues

Republican control of the US House, Senate and presidency sets the stage for fundamental tax code changes. One possible change under consideration is the House Republicans' Tax Reform Task Force Blueprint (Tax Blueprint) issued in June 2016,[2] which would replace the corporate income tax with a 20% "border-adjusted" destination-based business cash flow tax.

What is a 'border-adjusted' destination-based cash flow tax?

Taxes that are assessed where supply of the productive activity occurred can be thought of as assessed at *origin*. Taxes that are assessed where consumption of the productive activity occurred can be thought of as assessed at *destination*. Taxes that are assessed based on where the entity conducting the productive activity (or its parent or ultimate individual owner) resides can be thought of as assessed at *residence*. Destination-based value-added tax (VAT) is a type of cash flow tax assessed where consumption occurred.

A border-adjusted tax is a tax that is applied to all domestic consumption and excludes any goods or services that are produced domestically, but consumed elsewhere. In the case of VAT, border adjustment generally takes the form of exempting outbound transactions from taxation while allowing refunds of previously paid VAT. A border-adjusted destination-based cash flow tax would likely operate in a similar manner with regard to the exemption of export transactions from tax, although there presumably would not be prior stage taxes to refund.

The model adopted by the Tax Blueprint would tax imports to the extent that they produce cash flow due to sales activity in the US. In addition, it would not assess tax on cash flow that arose due to sales in a foreign location, effectively exempting exports from taxation (as is the case under the traditional VAT model).

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[1] Trump outlined the plan for the first 100 days on 22 October 2016 in "Donald Trump's contract with the American voter," available at assets.donaldjtrump.com/_landings/contract/O-TRU-102316-Contractv02.pdf.

[2] "A better way: our vision for a confident America," Tax, 24 June 2016 available at abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

Trade impact

How does this tax reform proposal potentially impact trade? First, the border tax/border adjustment provision is designed to encourage exports, which can have a significant impact on location of production and volume of trade. Second, the cash flow tax concept in the Tax Blueprint is relatively novel, and it is not entirely clear whether border adjustments will be allowed under the World Trade Organization (WTO) Agreements. Section XVI of the GATT 1994, and the Subsidies and Countervailing Measures (SCM) Agreement impose restrictions on export subsidies. Under the SCM Agreement, the full or partial exemption, remission or deferral specifically related to exports of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises is considered an impermissible export subsidy; but an exemption of an exported product from taxes borne by the like product when destined for domestic consumption is allowed. The cash flow tax concept has elements of both traditional indirect and direct tax systems. The Tax Blueprint states that the border adjustment mechanism is consistent with WTO rules, but, of course, other WTO members may disagree. As result, this mechanism could invite a challenge by a WTO member, and with any challenge comes risk of retaliatory trade measures if the challenge prevails.

Additionally, the border-adjustment aspect of a cash flow tax is designed to address some of the same trade-related issues that were discussed during the campaign. For example, one of the Trump campaign's criticisms of the North American Free Trade Agreement (NAFTA) was the perceived inequity of US-made products being imported into Mexico and subject to Mexican VAT, while Mexican made products may be imported into the US untaxed. A border-adjustment tax would balance the perceived inequity. A border-adjusted cash flow tax would also incent US manufacturing to remain in the US, and would impose a border tax on products made outside the US, which is consistent with the goals stated for the End the Offshoring Act proposal discussed below.

Potential withdrawal from or renegotiation of NAFTA

The 100-day plan states that the President will announce his intention to renegotiate NAFTA or potentially withdraw from it entirely. There are likely a number of ways in which renegotiation of NAFTA might proceed; NAFTA does have an established process for amendments, but the parties could decide to operate outside that framework. Article 2205 of NAFTA provides that any party can withdraw from the agreement on six months written notice. More detail on the process is discussed in "What is next for NAFTA?" article in this issue of *TradeWatch*.

The process that would follow such a withdrawal is murky at best, considering that the US has not taken similar action with respect to a trade agreement since the Civil War era. Existing law, however, provides some guidance as to the amount of flexibility the President has in light of withdrawal.

The North American Free Trade Agreement Implementation Act, passed in 1993, would remain in force until it is repealed or a replacement law is passed by Congress and signed by the President.[3] However, this legislation is silent as to what would occur in case of a unilateral US withdrawal. If withdrawal were to occur, the President would presumably seek congressional approval to repeal existing provisions of law that were required by NAFTA.

The Trade Act of 1974, as amended over the years, places certain limited restrictions on the President's powers to alter tariffs in the event of a full withdrawal from NAFTA. Under Section 125(e) of the Trade Act, termination of a trade agreement would not lead to an automatic change in import tariffs for one year, unless

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3 Public Law 103-182, December 8, 1993.

the President issues a proclamation that tariffs "shall be restored to the level at which they would be but for the agreement."[4] The President has 60 days from withdrawal to transmit to Congress "recommendations as to the appropriate rates of duty for all articles that were affected by the termination or withdrawal." Generally, Section 125(c) of the Trade Act limits new duties imposed under this section to between 20% and 50% higher than the tariff that was in effect in 1974 for the affected products.[5] Presumably as to Mexico, the applicable "but for the agreement" tariff rate would return to the "normal trade relations" (most-favored-nation) rates applicable under US law for WTO members, where the average tariff across the board is approximately 3.5%. The situation is less clear with regard to Canada. The US and Canada had a preexisting free trade agreement dating to 1989, which was superseded by NAFTA. There has been no indication to date from the President-elect as to whether or not that status might remain in the event of NAFTA termination. Similarly, the rates applicable to US products sent to Mexico would be the most-favored-nation rates. Average tariff rates in Mexico, of course, are significantly higher than in the US, and are currently approximately 7.7 % on industrial goods. The Canadian situation for imports of US goods into Canada is again unclear in light of the preexisting free trade agreement.

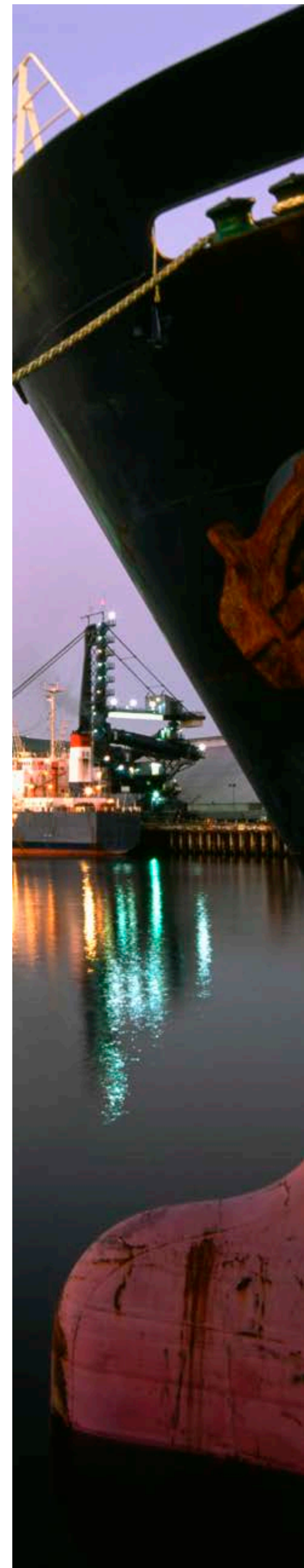
Designation of China as a currency manipulator

President-elect Trump has stated that upon taking office he will direct his Secretary of the Treasury to label China a currency manipulator. The statute underlying such a designation, the Trade Facilitation and Trade Enforcement Act of 2015,[6] sets forth at Section 701(a) three criteria that must be analyzed and evaluated before a country is labeled as a currency manipulator — the country must have:

1. A significant bilateral trade surplus with the US
2. A material current account surplus
3. Engaged in persistent one-sided intervention in the foreign exchange market[7]

In its most recent report on the matter (October 2016), the U.S. Department of the Treasury found that China met only one of these criteria — a large bilateral trade surplus with the US.[8] Therefore, the new administration would have to determine that the other two criteria were also met before labeling China as a currency manipulator. The incoming administration's views regarding how China would meet these objective criteria are unclear. That said, the statute itself leads to no direct consequences for China beyond a requirement for consultation and further engagement. While consideration was given to specifically providing for consideration of currency manipulation in US countervailing duty (CVD) law, the final provisions of the Trade Facilitation and Trade Enforcement Act of 2015 did not include such a provision.

Even without specific procedures for approaching currency manipulation through US CVD rules, the incoming administration could take a different approach and seek to treat currency manipulation, however defined, as an unfair trade practice requiring investigation and response. The International Trade Administration (ITA), part of the U.S. Department of Commerce, is the lead agency with respect to investigations of unfair trade practices. The ITA's goal is to defend US companies and the economy itself against foreign governments subsidizing the exports of their own domestic manufacturers. If the ITA process results in a determination of harm, the President could theoretically impose CVDs as a means of addressing the harm. While there is some basis in the WTO SCM Agreement to view certain types of currency manipulation as a subsidy, a country-wide CVD would be unprecedented, and would seem vulnerable to challenge as violating a requirement that CVDs be imposed (if at all) on a specific, targeted basis. As a



4 19 USC § 2135(e).

5 19 USC § 2135(c).

6 Public Law 114-125.

7 19 USC § 4421(a)(2)(A)(ii).

8 US Department of the Treasury, Office of International Affairs, "Foreign exchange policies of major trading partners of the United States," report is available at treasury.gov/resource-center/international/exchange-rate-policies/Documents/2016-10-14%20(Fall%202016%20FX%20Report)%20FINAL.PDF.

result, while declaring China a currency manipulator would undoubtedly start discussions with China, other potential actions are unclear.

Trade remedies and retaliatory duties

The Trump plan for his first 100 days also states Trump's intent to "direct the Secretary of Commerce and US Trade Representative to identify all foreign trading abuses that unfairly impact American workers and direct them to use every tool under American and international law to end those abuses immediately." These "tools," of course, can refer to existing US laws on antidumping and countervailing duties. The US currently enforces more than 300 antidumping and countervailing duty orders. More than 60 new investigations were initiated in 2015, which is the highest number since the 1990s. It is quite possible that investigations may see an even greater uptick.

Trump's campaign website also references several existing law provisions under which the President may take additional action, specifically Sections 201 and 301 of the Trade Act of 1974[9] and Section 232 of the Trade Expansion Act of 1962.[10] While the criteria described in the 100-day plan are quite general and undefined, existing law gives the President significant flexibility to craft responses to allegedly unfair trade practices both with and without congressional participation.

For example, the possibility of retaliatory duties being assessed against China and Mexico were specifically referenced during the campaign. Section 301 of the Trade Act of 1974 provides the President and the U.S. Trade Representative sweeping powers to impose new tariffs, and other restrictions on countries engaged in practices determined to be "unjustifiable" or "unreasonable," among other criteria.[11] There are various procedural and consultative requirements associated with taking such action, but the powers themselves are clear. Similarly, most US trade sanctions programs imposing embargos on countries like Iran and Syria are based on presidential invocation of the International Emergency Economic Powers Act (IEEPA). Under IEEPA, the President could declare a national emergency with respect to imports from a specific country and likely impose tariffs or other restrictions on that basis.[12] Additionally, Section 201 of the Trade Act of 1974 provides for the imposition of safeguard measures, which generally apply to categories of imports, rather than items of a specified country. President George W. Bush, for example, imposed safeguard measures on steel imports in 2002, which were terminated in 2003 following a WTO challenge.

As referenced on the Trump campaign website, the new administration may also look to use Section 232 of the Trade Expansion Act of 1962. If the President takes action to "adjust imports of an article and its derivatives" under this statute, these measures may be implemented relatively quickly. Mandatory procedural steps include an investigation by the Secretary of Commerce, submission of a report to the President (published in the Federal Register) and the President's determination of the nature and duration of any action that must be taken. Notably, the powers provided for in this section require a finding that the imports of "an article" potentially impair national security. The term "article" typically relates to a certain individual type of good, which theoretically could be extended to an industry under certain circumstances. More expansive use of this provision (i.e., to restrict or otherwise burden all imports from China) would be novel.

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[9] 19 USC § 2251 and § 2411, respectively.

[10] 19 USC § 1862.

[11] 19 USC § 2411.

[12] 50 USC § 1701 et seq.

Any of these potential actions could, of course, generate controversy both from US businesses at home, and from foreign governments.

End the Offshoring Act

The 100-day plan also calls for the introduction of legislation titled the End the Offshoring Act. The stated goal is to provide incentives to keep production in the US, and to establish tariffs on products shipped back to the US. As noted above, the border-adjusted cash flow tax proposal in the Tax Blueprint seems to address the same objective.

Final thoughts

The potential for significant change seems readily apparent from the 100-day plan, but any details on specific changes are speculative. With regard to the administrative actions that seem likely, such as a request to, at a minimum, amend NAFTA, it could be advantageous for businesses to identify specific amendments that may prove beneficial. For example, a business may benefit from a change to a specific product rule of origin, or from the elimination of the NAFTA, Article 303 restrictions on drawback and duty deferral programs.

Businesses may have a short window to communicate these suggestions to a new administration and will want to position themselves to be able to do so quickly and succinctly.

As the new administration takes office and begins to act, business may have to act nimbly to position itself for a variety of potential outcomes. Without specific proposals it is difficult to develop strategy, but businesses with significant trade activity are well advised to be sure that trade data is available to rapidly analyze in light of specific proposals and model potential outcomes so that they can develop and implement strategic business responses.

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What is next for NAFTA?

The North American Free Trade Agreement (NAFTA) among the US, Canada and Mexico entered into force on 1 January 1994, and created one of the world's largest free trade areas. One of the first comprehensive free trade agreements worldwide, NAFTA set a valuable example for other free trade agreements for countries around the world.

Under NAFTA, import duties on all covered goods traded within the US, Canada and Mexico were gradually phased out and, as scheduled, on 1 January 2008, all remaining duties and quantitative restrictions were eliminated.

Products manufactured in any NAFTA country that meet the applicable rules of origin established under NAFTA may be considered "NAFTA originating" and thus can be imported into any NAFTA country without payment of duties. This has led to a high degree of integration in the industrial production chains of items that are manufactured and sold in the US, Canada and Mexico, and also for products that are exported from North America to the rest of the world.

Based on statements during the campaign and since the election, the incoming administration intends to pursue an aggressive series of amendments to NAFTA or even the complete withdrawal from the agreement. While no concrete proposals for potential amendments have been put forward yet, we are including some thoughts on the various alternatives to amend NAFTA or to withdraw from the agreement entirely.

Established structure for amendments

One option for the incoming administration would be to take advantage of existing structures and procedures for proposing changes. While NAFTA itself has not been subject to substantial amendments since its entry into force, there are some examples of modifications to the agreement reflecting decisions reached by all three countries through the NAFTA Free Trade Commission.

NAFTA's Article 2001 establishes the Free Trade Commission, which is comprised of officials responsible for foreign trade from each NAFTA country (the US Trade Representative, Canada's Minister of International Trade and Mexico's Secretary of Economy). Its purpose is to supervise the implementation and interpretation of the agreement and solve any disputes from differences of interpretation.

The Free Trade Commission supervises the various committees and working groups established under NAFTA (i.e., those established under Annex 2001.2 including committees on trade in goods, agricultural trade and rules of origin, among others).

Throughout the years, the Free Trade Commission has adopted modifications to NAFTA, for instance liberalizing the rules of origin or amending procedures for binational panel reviews, which are then implemented through local legislation. The implementation requirements may vary by country. For example, in Mexico, in order for the modifications to enter into force the executive branch of the government, usually through the Ministry of Economy, publishes an "Accord in the Mexican Official Journal," which makes the amendments official. In the US, the proposed amendments follow the rulemaking process until the corresponding NAFTA implementing regulations are published in the Federal Register.

As such, there is an established structure under NAFTA that has acted as the vehicle for negotiations among the NAFTA countries and for implementing amendments to adjust the agreement. While the potential negotiations could be undertaken at the cabinet level and be performed directly between the representatives of the NAFTA parties, the Free Trade Commission could be a useful mechanism to discuss potential amendments.

Comprehensive negotiations

While the NAFTA Free Trade Commission has enacted modifications to the agreement, these have not included major changes or additions to the original text of the agreement. In fact, the Free Trade Commission is in charge of overseeing NAFTA's further elaboration, which may be interpreted as allowing the Free Trade Commission to enact more significant changes or even additions to the original text of the agreement.

If this is not the case, the NAFTA parties may, under NAFTA's Article 2202, agree on any modifications or additions to the agreement that will have to be subject to approval in accordance with the applicable legal procedures of each country.

Under the Article 2202 alternative, negotiations could be undertaken directly among the US, Canadian and Mexican governments without using the Free Trade Commission. If negotiations are performed under this alternative, any amendments made to NAFTA will likely have to follow the applicable legal procedures in each of the countries, which may lead to requiring domestic legislative approval and delay the implementation of potential amendments. In the United States, modifications to the agreement itself would likely involve amendment to existing legislation (for example, the North American Free Trade Agreement Implementation Act, as discussed below). This would require congressional action and presidential signature to take effect.

Withdrawal

Under Article 2205, any country may withdraw from NAFTA six months after it provides written notice of withdrawal to the other NAFTA countries. If one of the countries withdraws, the agreement would remain in force for the remaining countries.

Under US law, the President would likely have the sole power to issue such a notice, without requiring congressional approval or acquiescence. Although a trade agreement like NAFTA has not been terminated in more than 100 years in the United States, principles of US constitutional law suggest that the President's authority to terminate an executive agreement such as NAFTA is relatively unrestricted. For example, prior presidents have unilaterally terminated a mutual defense treaty with Taiwan and ended US accession to the Anti-Ballistic Missile Treaty. At the very least, even if the president issued an Article 2205 notice and a party brought a legal challenge, a US court would be unlikely to issue a ruling because the dispute would be considered a political question rather than a legal one.

Importantly, NAFTA was implemented in US law through the North American Free Trade Agreement Implementation Act of 1993. This nearly 200-page text made NAFTA-related changes to US law that would require further congressional action to change; in other words, a presidential withdrawal from NAFTA as an agreement among the three countries would not automatically repeal the implementation act as a matter of US law, there would need to be parallel action taken by Congress. The implications of this possible discontinuity between a terminated international agreement and existing domestic legal provisions could lead to uncertainty, especially in the short term.

Preparing for change

With amendment of NAFTA likely to be proposed early in the new Trump administration, business would be well-served by considering specific types of amendments that may be beneficial. For example, product-specific rules of origin may be changed that could impact qualification for duty-free treatment. NAFTA Article 303, which restricts drawback and use of duty deferral programs for goods traded among the NAFTA countries, has been identified by some companies as unfairly restricting trade. No process has yet been announced to allow business input into any proposals that the US may make to amend NAFTA, and as the timeframe for any input may be short, businesses may be well advised to put together a NAFTA "wish list" that can be quickly shared if the opportunity arises.

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Technical Committee on Customs Valuation concludes franchise fees are not dutiable additions to value

The Technical Committee on Customs Valuation (TCCV) has completed its review of a fact pattern involving the proper customs value of goods imported by a franchisee that may only be purchased from the franchisor, or a party authorized by the franchisor. The TCCV determined that a franchise fee payable by the franchisee based on the net sales of the franchise are not related to the imported goods, and consequently are not additions to the transaction value of the imported goods.

The TCCV is a committee of customs authorities created by the World Trade Organization (WTO) Valuation Agreement and tasked with providing interpretation and guidance on the Valuation Agreement. The World Customs Organization (WCO), an intergovernmental organization of 180 customs authorities, administers the TCCV. While its guidance is not binding on any jurisdiction, customs authorities worldwide regularly cite its pronouncements.

Fact pattern

The scenario under review involved a bakery franchise. The franchise agreement requires that certain specified ingredients to be used by the franchisee in preparing the baked goods must be purchased from the franchisor, or a party authorized by the franchisor. These types of provisions are not uncommon in food and restaurant franchises, in which the consistency of the franchise products is of paramount concern to the franchisor. Each time the franchisee purchases the ingredients there is a separate invoice and payment for these ingredients.

The franchise agreement also provides that the franchisee pay the franchisor a monthly franchise fee based on a percentage of gross sales generated at each store location. The franchise fee is compensation for the use of the franchised brands and systems. This type of payment is standard for most types of franchises.

Applicable rules

Article 1 of the WTO Valuation Agreement defines transaction value as the price actually paid or payable for goods when sold for export to the country of importation. The Interpretive Notes to Article 1 make clear that any payment made directly or indirectly by the buyer to the seller is part of the transaction value, provided the payment is for the imported goods.

In addition, Article 8 of the WTO Valuation Agreement requires that transaction value be adjusted to include specified additions to value. One of the required additions specified in Article 8.1(c), is for royalties paid by the importer of a product to someone other than the seller of the product. The royalty is an addition to value when the royalty:

1. Is related to the imported product
2. Must be paid as a condition of the sale of the product to the importer

As a result, if the franchise fee is determined to be related to the imported ingredients, there would be basis to include the franchise fee, or a portion of it, as part of the transaction value for the ingredients regardless of whether the ingredients were sold by the franchisor, or by an authorized third party. If the franchise fee is related to the ingredients, and the ingredients are sold by the franchisor, the franchise fee would be part of the price paid or payable for the ingredients. If the franchise fee is related to the ingredients, and the ingredients are sold by a third party, the franchise fee would be a royalty added to transaction value.

Conclusion reached — formal instrument to come later

The TCCV reached a consensus that the franchise fee is not related to the imported ingredients. Instead, the franchise fee is consideration paid for the intellectual property (IP) rights to operate the franchised stores. The fact that the ingredients are used to make products that are sold at the stores does not create the relationship between the imported ingredient the franchise fee.

Normally, a TCCV conclusion with regard to a specific fact pattern would only occur where the fact pattern is detailed and documented, and the TCCV delegates agree on the specific language to be used to describe the facts, analysis and conclusion. In this case, which several delegates noted may be the first of its kind, the conclusion was reached without specific language. The TCCV Chair has directed the TCCV Secretariat to draft an instrument for adoption at the next TCCV meeting consistent with facts presented and conclusion reached.

Implications for importers

The decision by the TCCV is welcome news for importers, who have seen many customs authorities take increasingly aggressive views on additions to value, and have seen recent TCCV decisions on additions concluding that a fact pattern describes a dutiable addition to value. Importers are well advised, however, to closely examine the detailed language that the TCCV adopts, and particularly the analysis provided. In the current environment, where many customs authorities are looking for revenue and have expressed expansive views on the types of payments that constitute dutiable additions to value, close adherence to the specific language in the TCCV analysis may provide a "safe harbor" for importers with similar fact patterns. Franchise companies in particular may find it timely to re-examine the text of current franchise agreements with the TCCV instrument serving as a model to avoid additions to value.

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Canada and the European Union have signed the Comprehensive Economic and Trade Agreement

On 30 October 2016, Canadian Prime Minister Justin Trudeau, European Commission President Jean-Claude Juncker and European Council President Donald Tusk signed the Canada-EU Comprehensive Economic and Trade Agreement (CETA or the Agreement). Provisional application of the Agreement, which will eliminate up to 98% of tariffs on goods between Canada and EU countries prior to the CETA's formal ratification, is expected to follow in 2017.

The signing of the Agreement initially faced the prospect of significant delay when Belgium's Minister-President of Wallonia refused to support ratification. Last minute negotiations between Canada, EU leadership and Wallonia successfully convinced the latter to alter its stance on the Agreement and support ratification with minimal delay from the originally planned signing date, 27 October 2016.

Canada introduced implementing legislation for the Agreement on 31 October 2016 and aims to have the provisional elements of the Agreement in force by early 2017.[13] The current text of Bill C-30, the Canada-European Union Comprehensive Economic and Trade Agreement Implementation Act, foreshadows a fast-track implementation by Order in Council at a date to be determined. The EU Parliament will also have to vote on provisional application of the Agreement. Although there is no specific timetable for these events, Canada and the EU are aiming for timely ratification and implementation of CETA.[14]

CETA has been touted by both Canada and the EU as a "gold standard" trade agreement, and one of the most ambitious trade agreements to date. Indeed, full ratification of CETA will create a significantly liberalized market in goods and services affecting approximately 535 million people.

Implications

Approximately 75% of EU tariff lines currently apply duties on Canadian imports into the EU. Upon provisional application of CETA, an estimated 98% of tariffs on goods traded between the EU and Canada will be removed provisionally in 2017, with a remaining 1% to 2% to be eliminated over a period capped at seven years.

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13 First Session, Forty-second Parliament, 64-65 Elizabeth II, 2015-2016, House of Commons of Canada, *Bill C-30: An Act to implement the Comprehensive Economic and Trade Agreement between Canada and the European Union and its Member States and to provide for certain other measures, 2016*.

14 "Canada and EU sign historic trade agreement during EU-Canada Summit," *Prime Minister of Canada*, available at pm.gc.ca/eng/news/2016/10/30/canada-and-eu-sign-historic-trade-agreement-during-eu-canada-summit, 30 October 2016.

The elimination of EU tariffs is expected to benefit several economic sectors in Canada, including advanced manufacturing, agriculture and agri-food, automotive, chemicals and plastics, fish and seafood, forestry and value-added wood products, metal and mineral products, and technology.

Full ratification will lead to the removal of non-tariff barriers on trade in goods and services as well as customs and trade facilitation, conformity assessment, increased labor mobility, recognition of professional qualifications and increased access to government procurement contracts. Additionally, it is expected to boost bilateral trade by 20% and increase Canadian income by CAD12 billion (approximately USD8.9 billion) annually. Full ratification, however, will require the unanimous support of all 28 EU Member States. There is no scheduled timetable or deadline for full ratification.

Canada's dairy industry has expressed concern over the potential economic impact of the tariff rate quota (TRQ) for cheese agreed to under CETA.[15] Canada and the EU have agreed to set a bilateral quota of 17,700 metric tons of cheese: 16,000 metric tons are dedicated to high-quality cheeses, while the remaining 1,700 metric tons are earmarked for industrial cheese. An additional 800 metric tons of high-quality cheese will be allotted by an adjustment to the EU portion of an existing World Trade Organization (WTO) TRQ.[16] Canadian dairy producers have been engaged in talks with the federal government since 2013 over a potential package of federally sponsored measures to mitigate the expected economic impact of increased foreign imports of cheese on the dairy supply management system due to CETA.[17] On 10 November, the Canadian federal government announced it will be investing CAD350 million (approximately USD260 million) in the dairy sector over five years, to assist in upgrading capital equipment and modernizing operations to support the competitiveness of the dairy sector.[18]

It remains to be seen whether the process for full ratification of CETA will encounter as many difficulties and delays as the process for provisional signing of the Agreement experienced. Implementation of the Investor-State Dispute Settlement (ISDS) system is not part of the provisional application of the Agreement; ISDS is the most controversial element of CETA among the Canadian and European electorate, and was one of the main reasons behind Wallonia's initial reluctance to sign CETA. Austria had also expressed reservations on ISDS earlier in 2016.

Growing global anti-free trade sentiment will most likely be a factor in the timing and progress of CETA's full ratification, especially considering several general elections are scheduled in Europe in late 2016 and 2017, and anti-trade political parties are growing in popularity. Most recently in the Netherlands, anti-CETA sentiment appears to be gaining enough support to potentially lead a referendum on CETA sometime in early 2017.[19] A Dutch referendum in April 2016 effectively blocked a Ukraine-EU political, trade and defense treaty, although the referendum barely managed to gather enough votes to be valid.[20]

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[15] "Quebec cheesemakers worry CETA deal could harm local industry," *CBC News*, cbc.ca/news/canada/montreal/ceta-quebec-cheese-1.3829391, 31 October 2016.

[16] European Commission statement, *CETA – Summary of the Final Negotiating Results*, European Commission, 2016 (accessed via trade.ec.europa.eu, 4 November 2016).

[17] "Dairy Farmers of Canada React to CETA Signing," D*airy Farmers of Canada website*, dairyfarmers.ca/news-centre/news/policy/dairy-farmers-of-canada-react-to-ceta-signing, 31 October 2016.

[18] "Government of Canada Invests in Dairy Sector in Anticipation of CETA," *Agriculture and Agri-Food Canada*, news.gc.ca/web/article-en.do?nid=1151379, 10 November 2016.

[19] "Dutch activists amassing signatures for referendum on EU-Canada trade deal," *Reuters Canada*, ca.reuters.com/article/topNews/idCAKBN12Z20K, 4 November 2016.

[20] "Netherlands rejects EU-Ukraine partnership deal," *BBC News*, bbc.com/news/world-europe-35976086, 7 April 2016.

In the near future, provisional ratification of the Agreement will open up interesting trade and investment opportunities for Canadian businesses at home and in the EU. However, anti-trade sentiment in Europe and scheduled elections in various Member States will likely impact the full ratification timeline, and it remains to be seen how successful Canada and the EU will be in keeping the ratification process on track.

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Brazil

Brazilian Superior Court rules that local terminal handling charges (*capatazia*) may not be included in the customs value

The Brazilian Superior Court of Justice (the Court) recent decision that post-importation terminal handling charges (THC; *capatazia* in Portuguese) may not be added to the customs value, and will give importers an opportunity to challenge and possibly receive refund of the difference of import taxes overpaid due to THC as part of the tax base paid during the last five years.

According to Brazilian customs law (implementing the World Trade Organization Customs Valuation Agreement, Article 8b), the following costs must be added in the customs value:

- Transportation costs of the imported goods to the port or place of importation
- Loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation
- Insurance costs

Under authority of this law, a Brazilian Customs regulation (Normative Instruction SRF 327/2003) established that THC to unload goods at the port of destination should also be included in the customs value.

Because of differences in interpretation, taxpayers in Brazil challenged this regulation and recently the Court decided that THC should not be included in the customs value of imported goods.

According to the Court's decision, the loading, unloading and handling charges that are eligible to be included in the customs value are charges incurred *before* the arrival at the port or place of importation where customs clearance takes place. As THC are collected at the place of importation (after the goods have been imported), it should be excluded from the customs value.

This decision may have positive impact for importers, as the customs value is the basis for all taxes levied upon the importation of goods. Therefore, whenever THC are not included in the customs value, importers will realize tax reduction.

Note that even though the decision is only applicable to the importer who filed the lawsuit, it is indicative of how the Superior Court may decide future similar cases.

It is also possible that the Brazilian Tax Authorities will appeal the decision.

In light of the above, importers who take advantage of this opportunity and consider challenging any additions of THC in the customs value of their imported goods to request refund of overpaid taxes over the last five years may realize important tax savings.

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Colombia

New Resolution regarding Special Import and Export Programs (Plan Vallejo)

Colombia's Ministry of Commerce, Industry and Tourism (MinCIT) recently issued Resolution No. 1649 of 2016 (the Resolution), which aims to modernize certain foreign trade facilitation instruments.

The special import and export programs in Colombia, also known as Plan Vallejo, provide for import duty exemption or suspension, or deferred payment of value-added tax (VAT), for temporary importation of goods, such as capital goods, raw materials, inputs and spare parts. To obtain these benefits, importers and exporters must comply with certain requirements, especially as they pertain to export of finished goods or services.

This Resolution introduces important amendments and modifications to the programs' legal framework, as follows:

- Importers and exporters may submit the application and its amendments, compliance demonstration studies, program extension requests and supporting documents through a MinCIT web platform.
- After a request is submitted, the MinCIT will have one month to assess whether to approve or deny the request and issue the corresponding administrative act.
- Business associations will be able to take advantage of Plan Vallejo benefits for the import of capital goods and spare parts.
- A request to extend the time for showing compliance with export requirements must be submitted not later than 30 days before it is due.
- The Assessment Committee has been reactivated. The main functions of this Committee are to adopt general application criteria for operations carried out under a Plan Vallejo program and to determine criteria for decision-making regarding applications or requests.
- Plan Vallejo's beneficiaries are required to submit only one residue control report regarding their residue destruction or recycling process.
- The Resolution introduces administrative control measures within the sanctions regime, such as written reprimand, import suspension and program cancellation.

- Plan Vallejo's Major Users recognition is granted to trusted trade users, such as Authorized Economic Operators (AEO), Permanent Customs User (*Usuario aduanero permanente,* UAP) or Highly Exporting Users (*Altamente exportador,* ALTEX) for the last five years.

  Each of these status designations provides the following benefits:

  (i) The status will be one of the factors considered in the Risk Management System to obtain a faster response to all requests.

  (ii) Access to rotating import quota.

- The Resolution is in force as of 8 October 2016.

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Mexico

Recent changes to the Mexican General Foreign Trade Rules

On 19 October 2016, the Mexican Tax Administration Service issued the second set of modifications to the 2016 General Foreign Trade Rules (GFTR). The GFTR, issued annually, apply to foreign trade operations and are subject to modifications throughout the year. We highlight some of the most relevant changes below:

Deferral of new requirements to substantiate the customs value of imported goods

In the December 2015 issue of *TradeWatch* we described the new requirements that importers will have to meet as a result of the amended Mexican Customs Law Regulations. The provisions of Article 81 of the regulations now require that importers submit at the time of importation, attached to the customs value statement, various documents including:

- Commercial invoice
- Bill of lading, packing list, airway bill or other transport documents
- Documents demonstrating country of origin, when applicable
- Documents demonstrating payment for the goods, such as electronic transfers or letters of credit
- Documents related to transport, insurance and costs related to the operation
- Contracts related to the transaction of the imported goods
- Documents supporting any additions to value that must be included in the customs value of the goods
- Any other information and documentation necessary to determine the customs value of the goods

Recognizing that these new documentary requirements are broad and could cause significant administrative burdens for importers, the authorities have deferred the entry into force of the Mexican Customs Law Regulations, Article 81, so that additional guidelines that clarify the extent of required documentation may be issued. The recent GFTR amendments move the effective date of Article 81 provisions to 1 June 2017.

Elimination of provisional value declaration

Until recently, companies operating under the IMMEX/maquila program as well as under the strategic bonded warehouse customs regime (*Recinto Fiscalizado Estratégico,* (RFE)) were able to declare a provisional value on their temporary importations. This provisional value could be based on the value declared for purposes of the transport insurance or other objective element that reflects the value of the goods. This was a useful benefit because it allowed certain companies operating under these programs to declare a provisional value that could later be adjusted in the event the goods were imported on a permanent basis rather than exported. It is worth noting that declaring a provisional value also exempted importers from filing the customs value statement.

Under the recent amendments to the GFTR, as of 19 December 2016, the benefit of declaring a provisional value will be eliminated and companies operating under an IMMEX/maquila program or under the RFE customs regime will need to declare the customs value of the goods according to the customs valuation provisions under the Mexican Customs Law and its Regulations.

In addition, companies operating under an IMMEX/maquila program or under the RFE customs regime will also need to file the customs value statement (along with the additional documentation that will be required starting 1 June 2017), unless they obtain the value-added tax (VAT) certification issued by the tax authorities that exempts them from this requirement.

It is important for affected companies to ensure that they have the appropriate procedures in place to declare the customs value of goods imported on a temporary basis, particularly since the customs authorities are increasing the scrutiny of customs valuation as part of their audit efforts.

Notification to importers of FTA origin verifications

The recent amendments added a new Rule 6.3.1 to the GFTR, which requires the customs authorities to notify Mexican importers when an origin verification on the producers or exporters of products imported by the Mexican importer is initiated under the mechanism of any Free Trade Agreement (FTA) to which Mexico is a party. If applicable, the authorities will be required to notify the Mexican importer of the preliminary resolution to deny preferential treatment to the imported goods as well as the final resolution that determines the originating or non-originating status of the goods.

This is a welcome addition to the GFTR since the customs authorities are now changing their procedures to focus their country of origin confirmation directly with the exporter or producer through the process of origin verification instead of auditing the Mexican importer of the goods. Before the GFTR amendments, the authorities were not required to inform the Mexican importer that a verification procedure has been initiated on its suppliers. The change will give greater certainty to Mexican importers as the frequency of origin verifications by the authorities is expected to increase.

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United States

Foreign national employees and export controls

The hiring of foreign nationals to work in the United States may generate the requirement to review whether US Government authorizations in addition to a work visa (such as an export agreement or export license) may be necessary to enable foreign national employees to participate in the activities contemplated by their US employer.

Companies in the United States hire foreign nationals because they need specialized talent to expand their pool of trained workers.[21] Companies are able to hire foreign nationals to work in the US by utilizing worker authorizations, such as the H-1B visa. Any company that has applied for a worker authorization is familiar with the required immigration documentation and is likely to have developed appropriate human resource processes. Nevertheless, if a company does not have robust export compliance processes interwoven with these hiring practices, the company is exposed to increased risk for compliance gaps.

A recent enforcement action by the U.S. Department of State (DOS) against a prominent engineering and manufacturing company serves as a reminder to US companies that obtaining a worker authorization, such as an H-1B visa, does not authorize the transfer of any export-controlled items to a foreign national employee. The DOS' Proposed Charging Letter of the engineering and manufacturing company alleged unauthorized transfers of controlled technical data to a foreign national employee from the People's Republic of China who was working legally in the United States under an H-1B visa.[22] As part of the settlement, the company will pay a civil penalty of USD100,000.[23]

A note on US export regulations

Companies must comply with each of two legal regimes that regulate export activity in the US:

1) The Export Administration Regulations (EAR)
2) International Traffic in Arms Regulations (ITAR)

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[21] Alexia Elejalde-Ruiz, "Foreign workers waiting to win the H-1B lottery," *Chicago Tribune*, 15 April 2016 available at chicagotribune.com/business/ct-h1b-visa-applications-0417-biz-20160415-story.html.

[22] Text of *Proposed Charging letter,* U.S. Department of State available at pmddtc.state.gov.

[23] Text of *Order*, U.S. Department of State, 20 June 2016 available at pmddtc.state.gov.

Under the EAR, a release to a foreign national employee in the United States of EAR-controlled technical data is a "deemed export" to the employee's most recent country of citizenship or permanent residency.[24] Technology is considered transferred for export when it is made available to foreign nationals for visual inspection, when it is exchanged orally or when it is made available by practice or application under the guidance of individuals with knowledge of the technology.[25]

Under the ITAR, an export occurs whenever technical data is released or otherwise transferred "to a foreign person in the *United States* (a "deemed export")."[26]

Although the two regimes address the issue of transfers of controlled items differently, the main takeaway is that transfers within the US require as much of an analysis for export control purposes as transfers outside the US. Thus, companies have a duty to comply with the requirements that control the export of goods, technologies and software both outside of the US as well as transfers *inside* the US.

It is critical that a company examine its goods, technologies and software against the classes of items that are controlled by the EAR and ITAR, and assign export classifications on a case-by-case basis. In addition to having the proper resources allocated to assigning export classifications, a company must also have the systems in place to make that information available for use in downstream export analysis activities.

Export controls in relation to the hiring of foreign nationals

US employers have several options when hiring foreign nationals to work in the US. For example, technology companies often use the H-1B worker visa because it is intended for employees engaging in specialty occupation services. It allows an employee to work up to three years in the US, with the possibility of renewal for an additional three years.

Regardless of the type of work visa used, however, US companies petitioning to hire foreign workers must also ensure compliance with all applicable export rules and regulations.[27] As noted above, temporary worker authorizations do not apply to transfers of export-controlled items. Where such transfers are necessary in the course of business, separate export authorization is required before any export-controlled goods, technologies and software may be transferred to the foreign national employee working in the US.

Companies must ensure that the proper processes are in place to adequately determine a potential foreign national employee's scope of work and identify the specific list of goods, technologies and software to which the employee may have access while performing his or her work duties in the US. Next, companies must determine whether the list contains any controlled items. If controlled items are identified, the company must determine whether prior authorization from the US Government is required and whether the US Government is likely to approve the proposed transfer. The employer must then obtain the necessary authorizations prior to any possible transfer of controlled items to the foreign national employee.

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[24] 15 CFR §734.14(b).

[25] 15 CFR §734.15.

[26] 22 CFR §120.17(a)(2) (emphasis added).

[27] All foreign nationals, except those granted permanent residence through permanent resident visa, US citizenship or status as a "protected person" under 8 U.S.C. 1324b(a)(3), need an export authorization when working with export-controlled technology.

To ensure authorization is received in a timely manner, the employer should integrate the timing of applying for and receiving the export authorization into the hiring processes. Additionally, a change in a current foreign national employee's work scope should trigger a process by which the list of goods, technologies and software is re-examined to determine whether existing export authorizations adequately cover the proposed work. Processes should also identify the people who are responsible for monitoring when such changes occur and provide the specific steps needed to conduct proper export compliance analysis.

Closing thoughts

Unauthorized transfers of controlled items can lead to fines, civil penalties, the revocation of export authorizations and administrative debarment of export privileges.

The civil penalties levied against the aforementioned engineering and manufacturing company are an example of the problems that may arise when a company falls short of its compliance obligations. Developing a compliance program that integrates the hiring process with export-specific processes as well as appropriate analysis and ongoing monitoring of foreign national employees' work-scope, will help to minimize the risk of improper transfers of export-controlled goods, technologies and software.

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Wassenaar Arrangement 2015 plenary agreements implementation: highlights and potential impacts

The Bureau of Industry and Security (BIS) has updated the Commerce Control List (CCL)[28] based on changes to the Wassenaar Arrangement's List of Dual-Use Goods and Technologies (WA List). On 20 September 2016, BIS published a Final Rule (the Rule)[29] that introduces several updates to the CCL to harmonize the changes to the WA List. The Rule revises certain Export Control Classification Numbers (ECCNs) that are controlled for national security reasons in each category of the CCL and makes other associated changes to the Export Administration Regulations (EAR).[30]

The WA objective is to improve regional and international security and stability. Currently, 41 countries[31] are members to the WA, including the US. The US, as a party to the WA, is committed to controlling the export for all items on the WA List.

Changes to export controls of encryption technology

Some of the most important changes pertain to the encryption items on the CCL.[32] Category 5 – Part 2 now separates encryption items into the following three distinct categories:

- 5A002: "Information security" systems, equipment and "components"
- 5A003 (new): "Systems," "equipment" and "components," for non-cryptographic "information security"
- 5A004 (new): "Systems," "equipment" and "components" for defeating, weakening or bypassing "information security"

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[28] The Commerce Control List (CCL) is codified in 15 C.F.R. 774.

[29] Bureau of Industry and Security, U.S. Department of Commerce, Wassenaar Arrangement 2015 Plenary Agreements Implementation, Removal of Foreign National Review Requirements, and Information Security Updates, Final Rule, 81 Fed. Reg. 64656, 20 September 2016.

[30] The Export Administration Regulations are codified in 15 C.F.R. Chapter VII, Subchapter C.

[31] Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Republic of Korea, Romania, Russian Federation, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom and the United States.

[32] Encryption items are covered in Category 5 — Part 2 to in Supplement 1 to 15 C.F.R. 774.

These changes result in corresponding changes in 5D002 and 5E002. Further, the Rule removes 5A992, 5D992.a and 5D992.b, and as a result, items meeting the Exclusion Note are now designated as EAR99. Additionally, Note 2 to Category 5 — Part 2, changes the term "encryption products" to "information security."

The Rule amends §740.17(b) to eliminate the encryption registration requirement. However, exporters who self-classify encryption products under §740.17(b)(1) will continue to be required to submit a self-classification report. The requirements for the self-classification report are moved from §742.15(c) to §740.17(e)(3).

The Rule introduces other important changes to §740.17 as follows:

- Paragraph (b)(2) is amended to authorize in-country exports, re-exports and transfers of "network infrastructure" items to "less sensitive government end users" in all countries except E:1 and E:2 countries.
- A definition of "less sensitive government end users" is added to §772.
- A new Paragraph (a)(1)(ii) authorizes in-country exports, re-exports and transfers among related parties for internal use when the parent company is headquartered in a country that is listed in Supplement No. 3 to §740 (License Exception ENC Favorable Treatment Countries).[33] No classification or reporting is required for such in-country exports, re-exports or transfers.

Additionally, the Rule amends Supplement No. 3 to Part 740 to add Croatia as a member of the European Union.

New ECCNs

Two new ECCNs added to the CCL warrant reevaluation and update to an exporter's encryption classification methodology and evaluation protocols:

- 5A003 controls items formerly classified as 5A002.a.8 and 5A002.a.4 (now 5A003.a and 5A003.b respectively). The corresponding license requirements and license exceptions remain unchanged.
- 5A004 controls items formerly classified as 5A002.a.2 subject to the license requirements and license exceptions that formerly applied.

Other important CCL changes

Amendments to ECCN 3A002:

- Heading to 3A002 has been revised to better reflect the scope of the entry.
- Missile Technology (MT) controls have been added to the License Requirements.
- Items paragraph 3A001.a.5 "waveform digitizers and transient recorders" is removed and reserved, because the items are now controlled under the newly added Items paragraph 3A002.h.
- The sample data rate parameter is deleted and the continuous throughput parameter is increased to avoid capturing predominantly commercial items.
- The phrase "sustained continuous throughput" is added to clearly distinguish from "peak data recording rate."
- Technical Notes for continuous throughput rate (previously included under 3A002.a.5) are added with the deletion of the term "mass" in Technical Note 3, Items paragraph 3A002.h.

[33] License Exception ENC (ENC is from encryption) Countries are listed in Supplement No. 3 to §740. Currently, as updated by the Rule, these countries are Austria, Australia, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Estonia, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and United Kingdom.

Amendments to ECCN 3D001:

- The reference to 3A002.g is replaced with 3A002.h.
- The same revision (as for 3A002) is made to the National Security (NS) control paragraph in the License Requirements table of 3D001.
- The eligibility paragraph of License Exception CIV[34] is replaced with N/A (Not Applicable), because 3B001.c is no longer controlled.
- 3E002 is amended by revising the CIV paragraph in the License Exception section to remove the Foreign National Review (FNR) Requirement.

Amendments to ECCN 4A003:

- 4A003.e "Equipment performing analog-to-digital conversions exceeding the limits in 3A001.a.5" has been removed and reserved and a Nota Bene is added to point to the new location for the control in 3A002.h.
- The License Requirements section is revised by removing the Missile Technology control, which only applied to 4A003.e.
- Reference to 4A003.e is removed from the List Based License Exceptions section.
- The "Adjusted Peak Performance" (APP) for "digital computers" is raised from 8.0 to 12.5 Weighted TeraFLOPS (WT) in Items paragraph .b in the List of Items Controlled section.
- Equipment designed for "signal processing," in Note 1 is removed.
- 4D001 and 4E001 are amended by removing NP from the Reason for Control.
- The Technology and software under restriction (TSR) paragraph in the List Based License Exceptions section is amended by revising the APP from 2.0 to 12.5 WT.

Additionally, the Rule makes a number of License Exception eligibility additions and removals.

High-performance computer Adjusted Peak Performance-related changes

The Rule raises APP numbers in Category 4 by WA agreements, and updates License Exception APP.

The list of 22 countries in §740.7(c)(3)(i) (countries eligible to receive technology and software for computers of unlimited APP under License Exception APP) has been replaced with the list of 36 countries in Country Group A:5 in Supplement No. 1 to §740. This adds 14 Computer Tier 1 countries[35] to the list of countries eligible to receive technology and software controlled by ECCNs 4D001 and 4E001. These countries are considered most trusted allies with like-minded export controls.

For the rest of Computer Tier 1 countries[36], the APP threshold for deemed exports of "development" and "production" computer technology and source code is raised from an APP of 25 to 40 Weighted TeraFLOPS (WT) in paragraph (c)(3)(ii). The threshold for "use" technology and source code is raised from an APP of 120 to 200 WT in paragraph (c)(3)(iii).

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[34] License Exception CIV pertains to national security items for civil end users.

[35] Argentina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Iceland, S. Korea, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

[36] Computer Tier 1 destinations include: Albania, Antigua and Barbuda, Argentina, Aruba, Australia, Austria, Bahamas (The), Bangladesh, Barbados, Belgium, Belize, Benin, Bhutan, Bolivia, Botswana, Brazil, Brunei, Bulgaria, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Chile, Colombia, Congo (Democratic Republic of the), Congo (Republic of the), Costa Rica, Cote d'Ivoire, Croatia, Curaçao, Cyprus, Czech Republic, Denmark, Dominica, Dominican Republic, Ecuador, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, Fiji, Finland, France, Gabon, Gambia (The), Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Hong Kong, Hungary, Iceland, Indonesia, Ireland, Italy, Jamaica, Japan, Kenya, Kiribati, Korea (Republic of), Latvia, Lesotho, Liberia, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Marshall Islands, Mauritius, Mexico, Micronesia (Federated States of), Monaco, Mozambique, Namibia, Nauru, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Palau, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Romania, Rwanda, St. Kitts & Nevis, St. Lucia, St. Vincent and the Grenadines, Sao Tome & Principe, Samoa, San Marino, Senegal, Seychelles, Sierra Leone, Singapore, Saint Maarten (the Dutch two-fifths of the island of Saint Martin), Slovakia, Slovenia, Solomon Islands, Somalia, South Africa, Spain, Sri Lanka, Surinam, Swaziland, Sweden, Switzerland, Taiwan, Tanzania, Togo, Tonga, Thailand, Timor-Leste, Trinidad and Tobago, Turkey, Tuvalu, Uganda, United Kingdom, Uruguay, Vatican City, Venezuela, Western Sahara, Zambia and Zimbabwe.

For Computer Tier 3 countries[37], the APP threshold for deemed exports of "development" and "production" technology and source code is raised from an APP of 12 to 16 WT in paragraph (d)(3)(i). The APP threshold for deemed exports of "use" technology and source code is raised from an APP of 25 to 32 WT in paragraph (d)(3)(ii).

EAR § 774 modifications

The Rule amends Supplement No. 2 to EAR 774 "General Technology and Software Notes" by adding paragraph 3 "General Information Security Note" (GISN) to alert the public to consider Category 5 — Part 2 when classifying information security items or items with information security functions.

An explanation about the use of Chemical Abstracts Service (CAS) numbers in the CCL is added in new paragraph (e) to §774.1 to help exporters to classify chemicals on the CCL.

The Rule amends a number of Paragraphs of Supplement No. 6 to EAR 774 "Sensitive List" to match the revisions made to corresponding ECCNs by the Rule. These changes will affect Wassenaar reporting requirements in §743.1.

Removal of the Foreign National Review procedure

The Foreign National Review (FNR) procedure was implemented in License Exceptions CIV in 2004 as a less burdensome procedure for authorizing deemed exports that would otherwise require licenses. Because the procedure has not been widely used, BIS is removing the FNR procedure from the EAR so that exporters may use License Exception CIV and APP for eligible deemed exports.

Additionally, License Exception CIV—§740.5 removes paragraph (d) under §740.5 (the requirement under License Exception CIV to submit an FNR request to BIS for deemed exports and re-exports of 3E002 technology to foreign nationals). The removal of this paragraph conforms to the removal of the FNR procedure from the EAR. This change allows exporters to use License Exception CIV for deemed exports of eligible 3E002 technology to a foreign national having a home country included in EAR Country Group D:1 without having to submit a FNR request to BIS.

Implication for US exporters

The changes in the CCL, some of which are mentioned above, are significant and may require reclassification of goods. Exporters need to pay special attention to the new methodology for classification of encryption goods and technology, the new license exceptions or requirements, and the different qualifications for export-controlled goods.

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[37] Computer Tier 3 destinations include: Afghanistan, Algeria, Andorra, Angola, Armenia, Azerbaijan, Bahrain, Belarus, Bosnia & Herzegovina, Burma, Cambodia, China (People's Republic of), Comoros, Djibouti, Egypt, Georgia, India, Iraq, Israel, Jordan, Kazakhstan, Kosovo, Kuwait, Kyrgyzstan, Laos, Lebanon, Libya, Macau, Macedonia (The Former Yugoslav Republic of), Mauritania, Moldova, Mongolia, Montenegro, Morocco, Oman, Pakistan, Qatar, Russia, Saudi Arabia, Serbia, Tajikistan, Tunisia, Turkmenistan, Ukraine, United Arab Emirates, Uzbekistan, Vanuatu, Vietnam and Yemen.

Expansion of Harmonized Tariff Schedule of the US Provision 9801.00.10 under the Trade Facilitation and Enforcement Act

The passage and entry into force of the Trade Facilitation and Enforcement Act of 2015 earlier this year has generated a considerable amount of attention in the trade community regarding changes to Duty Drawback and other reforms. Among these reforms is a somewhat lesser known provision expanding the definition of Harmonized Tariff Schedule of the United States (HTSUS) subheading 9801.00.10.[38] Heading 9801 of the HTSUS allows for the duty-free importation of goods that were previously exported from the United States and had not been advanced in value or condition through further manufacturing or processing. Specifically, subheading 9801.00.10 lists a large variety of goods including articles exported with intent to re-import after temporary use abroad, articles returned for repair or alteration before being re-exported, and goods within HTSUS Chapters that include chemicals, pharmaceuticals, jewelry, machinery, vehicles, aircraft and medical devices.

Before the new law went into force, 9801.00.10 allowed for the duty-free return of "products of the United States" previously exported without having been advanced in condition or value. Under the Trade Facilitation and Enforcement Act, the provision has been expanded to include "any other products when returned within three years after having been exported." As such, the expansion of 9801.00.10 potentially offers two primary benefits to US importers:

1) Duty-free re-importation under the provision is no longer limited to US-originating goods, as long as these goods were exported within the past three years (and not advanced in condition or value)[39]
2) Record-keeping requirements for claiming duty-free treatment under 9801.00.10 are reduced

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[38] *Trade Facilitation and Enforcement Act* of 2015, Pub. L. No. 114-125, 130 Stat. 224, available at congress.gov/bill/114th-congress/house-bill/644/text (last visited 17 November 2016).

[39] In determining whether an advancement in value or improvement in condition exists at the time of importation, CBP compares the overall value and condition of the merchandise at the time of export from the US with the value and condition at the time of return to the US. This determination is made on a case-by-case basis. For example, in HQ 559496 CBP held that cutting US-origin twine to length in Canada advanced the value of the article relative to its previous state and stated that it would not qualify for duty-free entry under 9801 provisions.

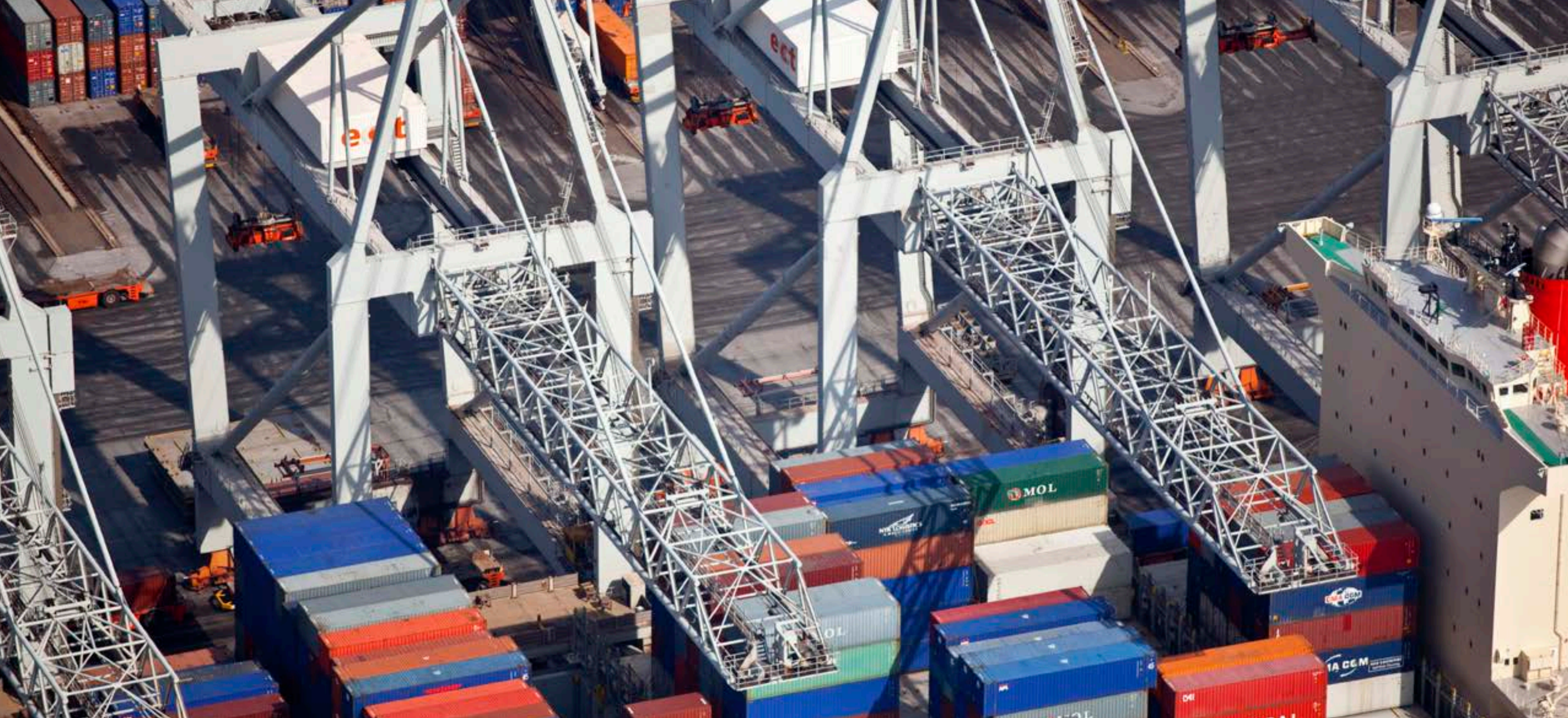
Before the changes went into effect, a signed Manufacturer's Affidavit or NAFTA certificate of origin was required to prove US origin, thus validating 9801.00.10 claims. Such documents will be unnecessary for both US origin and non-US originating products because there is no longer a distinction. An importer using 9801.00.10 for such products would only have to demonstrate that the export and re-import occurred within the past three years, in addition to any other requirements previously established under 19 CFR 10.1.[40]

Several common fact patterns will give rise to benefits under the new law, such as those outlined below:

1. **Returns for repair, deposit, exchange, etc.:** Companies that disassemble vehicle cores such as alternators or starters for return to the US (e.g., returned for repair, deposit, exchange, etc.).[41] In HQ 563353 (2005), U.S. Customs and Border Protection (CBP) permitted duty-free entry of disassembled aircraft engine parts returned to the US for repair. Likewise, unused articles that are returned to the US could also qualify for duty-free entry.
2. **Packaging:** Companies that package products abroad before re-importing into the US. This includes situations where the products are packaged with other goods. In Superscope, Inc. v. United States, 13 CIT 997, 727 F. Supp. 629 (1989), the court held that certain glass panels of US origin that were exported, repacked abroad with certain foreign components and returned to the US as part of unassembled audio cabinets, were entitled to duty-free entry. Other examples include duty-free entry of US-origin plastic bins returned with toys (HQ 545224, 1994) and duty-free entry of US-origin plastic overwrap used to package products (H261216, 2015).
3. **Warehousing:** Companies that warehouse or otherwise store products abroad before re-importing into the US. In N070123 (2009), CBP permitted duty-free entry of US-origin contact lenses that were sent from the US for warehousing in Germany and then returned.
4. **Testing:** Companies that test products abroad before re-importing into the US. In HQ 960554 (1998), duty-free entry was provided for US-origin power supplies, control units and two refrigeration systems that were connected to a physical vapor deposition apparatus in Great Britain for testing and then returned to the US.
5. **Scrap:** Companies that manufacture abroad and then re-import unused inventory, scrap or waste into the US. In Burgess Battery v. United States, C.D. 866 (1944), the court held that zinc scrap residue created from the manufacture of battery cups in Canada from US-origin zinc sheets, was entitled to duty-free entry. See also HRL 557348 (1993), where CBP allowed duty-free entry of fabric scraps created from the cutting of infant seat pads from US-origin fabric rolls.
6. **Hangers, tags, etc.:** In H028000 (2008), CBP permitted duty-free entry of security tags, which had been sent from the US to the foreign factory for affixing to the imported apparel. CBP would also likely afford hangtags, hangers and the like in a similar manner under the same circumstances.

[40] 19 CFR 10.1 clarifies that the port director must be satisfied that the requirements of subheading 9801.00.10 are met and may require additional information as necessary to substantiate the claim. 19 CFR 10.1(b) lists an export invoice as an example of documentation that may be requested.

[41] See HQ 561541.



Companies with US import and export operations are encouraged to review their existing operations to determine whether they can benefit under the new rule based on one or more of these scenarios. For example, companies with foreign assembly or distribution operations, including IMMEX/maquila operations, will likely benefit from:

1. Returns of raw materials or packaging of US or *foreign-origin* to the US
2. Returns of machinery/equipment of US or *foreign-origin* to the US for repair or otherwise (if not advanced in value or condition)
3. Packaging operations in Mexico where the packaged items of US or *foreign-origin* are returned to the US (if not advanced in value or condition)
4. Warehousing/storage of products that are returned to the US

Likewise, companies that operate service or repair centers in the US may be able to significantly reduce their duty payments under the new rule.

Importers with similar fact patterns stand to benefit immediately from the expanded 9801.00.10 provision since the effective date "applies to articles entered, or withdrawn from warehouse for consumption, on or after the date that is 60 days after the date of the enactment of this Act."[42] Since President Obama signed the Act on 24 February 2016, the expanded provision has been in effect since 24 April 2016. Importers are encouraged to file Post-Entry Amendments (or Post-Summary Corrections) on entries made on or after 24 April 2016 to the extent that they can support 9801.00.10 claims under the new rule.

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

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[42] Trade Facilitation and Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 224.

China

China to adjust consumption tax rates for cosmetic products

China's General Administration of Customs is implementing certain recent consumption tax changes that affect imported cosmetics. As of 1 October 2016, higher priced (high-end) cosmetics will be subject to 15% consumption tax, while lower priced mass-market cosmetics will be imported duty free. This constitutes a significant change from the past when cosmetic products were taxed according to product category rather than value. Cosmetic products are beauty, makeup, hair and skin-care products that are found in Chapter 33 of the Harmonized Tariff Schedule.

On 30 September 2016, the State Administration of Taxation (SAT) and Ministry of Finance (MOF) jointly issued the Circular on Adjusting Consumption Tax Rates for Imported Cosmetics (Cai Guan Shui [2016] No. 48) and the Circular on Adjusting Consumption Tax Policies for Cosmetics (Cai Shui [2016] No. 48).

On the same day, the General Administration of Customs issued GAC Notice [2016] 55 (the Notice) to implement the consumption tax adjustments noted above. Effective 1 October 2016, the Notice, which applies to both high-end and mass-market imported cosmetic products, adjusts tariff headings 33.03 and 33.04 to include certain tariff subheadings as well as adjusts the consumption tax rates for those tariff subheadings.

For example, the Notice replaces subheading 3303.00.0000 with 3303.00.0010 and 3303.00.0020 and replaces 3304.30.0000 with 3304.30.0001, 3304.30.0002 and 3304.30.0003. The new subheadings reference a value threshold.

Prior to the Notice, the consumption tax rates on cosmetic products depended on the particular category. Skin care products (3304.99.0010) and bath powder/talcum powder (3304.91.0001) were subject to 0% consumption tax, whereas the rate for other cosmetic products was 30%. According to the Notice, the consumption tax rate is now subject to a value threshold to differentiate the treatment applicable to imported high-end cosmetic products and mass-market cosmetic products. Products with a value greater than CNY10/ml or g, or CNY15/piece, are subject to 15% consumption tax. If the value is less than CNY10/ml or g, or CNY15/piece, the consumption tax rate is now 0%. This means that going forward, certain lower priced cosmetics that were previously subject to 30% consumption tax will now be exempt from consumption tax. At the same time, certain higher priced skin care products (e.g., certain products classified under 3304.99.0010 and 3304.91.0001) that were previously exempt will now be subject to a 15% consumption tax rate.

These recent changes will create opportunities and challenges for companies that import cosmetic products into China. The adjustment of consumption tax rates on cosmetics represents a policy change that will affect most cosmetic products, both with a value below as well as above the new threshold. A detailed analysis of a company's cosmetic imports and applicable pricing strategy will be critical. This is especially true when the value of the cosmetics is near the threshold mentioned above. Finally, importers should also become familiar with the new tariff subheadings introduced by the Notice.

Look for additional insight and updates in future issues of *TradeWatch*.

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Japan

Update on the liberalization of customs declaration policy

In the June 2016 issue of *TradeWatch*, we discussed the upcoming liberalization of customs declaration policy, in which the concept of jurisdictions for customs declaration will not apply to certified Authorized Economic Operators (AEOs). Under the new rules, AEOs engaged in import and export in Japan will be able to file import and export declarations with customs offices that do not necessarily have jurisdiction over the customs area where the goods are physically located.

Currently, importers and exporters are required to submit customs declarations to the customs office with jurisdiction over the customs area where the goods will be placed for import/export. This will remain unchanged for non-AEOs, unless they utilize the services of an AEO customs broker and AEO logistics operator. Under the new rules, AEO importers, exporters and manufacturers will be allowed to submit customs declarations to customs offices of their choice, regardless of the physical location of the pertinent cargo. These measures were designed to help AEOs reduce costs and operate more effectively.

Recently, Japan Customs announced that the new rules will be issued in October 2017. Although many of the details regarding the new policy are yet to be clarified, we will discuss some of the major aspects of the new rules recently made public by Japan Customs.

Independence of declaration and inspection

Since AEOs are accredited for compliance with relevant laws and the reliable management of their import/export operations, physical inspection of import/export goods is generally waived. However, should a customs inspection become necessary for goods declared in one jurisdiction, but stored in a different jurisdiction, the head of the customs office that received the declaration may request the head of the customs office where the physical goods are located to conduct the customs inspection. The new system relieves AEOs of unnecessary travel by improving communication between customs offices and separating the declaration and inspection processes.

Customs declaration for cargoes located in multiple warehouses located under the jurisdiction of one customs office

Currently, traders are required to file separate customs declarations for imported/exported goods by storage locations even when such goods arrive/leave in a single shipment. However, under the new rules, if the warehouses are under the jurisdiction of a single customs office and within one prefecture, AEOs may be permitted to submit a single customs declaration for such cargoes.

Filing amended returns

Importers and exporters must file amended declarations with the customs office in which the original declaration was filed. Where multiple ports are used, this generally meant declarations in multiple customs offices. Filing amendments can be an administratively burdensome process, especially in the case of retroactive transfer pricing adjustments, which entails the amendment of all affected import declarations filed within the period covered by the adjustment. Importers had to meet with multiple customs offices to explain and obtain approval for the amendments. Under the new rules, the AEO will be able to file customs declarations in a single customs office, regardless of the number of ports used, and the AEO will then be able to file amended declarations to a single customs office. This will alleviate some of the burdens related to costs and time incurred in filing amended declarations.

Coverage of the new provisions

In principle, all cargo will be subject to liberalized declaration through the Nippon Automated Cargo and Port Consolidated System (NACCS) once the revisions are fully in effect. The only goods excluded from this special provision will be weapon-related goods and goods under the Mutual Defense Assistance (MDA) Agreement. Certain restrictions will also apply to goods subject to the Washington Convention.

Requirement to use NACCS system for filing customs declaration

To benefit from the new rules, AEOs must file customs declaration through the NACCS electronic declaration system. The declaration process itself will also undergo significant changes. All declarations and supporting documents are to be submitted electronically except in cases of technical difficulty or when original documents are required. There are also plans underway to allow customs declarations to be made and processed around the clock. Though certain goods are still subject to physical inspection, which only can be completed within working hours, certain qualifying goods will be approved automatically even outside of working hours.

Conclusion

Many importers and exporters have been somewhat skeptical about obtaining AEO certification because the benefits did not appear to outweigh the burden of obtaining certification and maintaining AEO status. However, the implementation of the new customs declaration rules brings additional benefits to becoming AEO certified. Companies importing into or exporting from Japan may wish to consider applying for AEO certification to secure a competitive advantage.

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Customs annual report on post-entry audits for 2016

The annual post-entry customs audit report published by the Japanese Ministry of Finance was released on 4 November 2016. The released data indicates that customs audits were conducted more frequently and have become increasingly stringent as evidenced by the increase in both the number of audits and the amounts assessed.

The number of audited entities increased from 3,545 to 4,302 (a 21.4% increase), and the percentage of entities subject to assessments rose 26% from 2,363 entities to 2,977 entities. Penalties assessed for gross negligence increased by a staggering 4572.2% from the previous year.

The following were cited as the top five categories of products subject to assessments:

Items and Harmonized Schedule (HS) code	Duty/tax shortfall
1. Electrical equipment (Chapter 85)	JPY2.42 billion[43]
2. Optical instruments and apparatus (Chapter 90)	JPY2.12 billion
3. Meat (Chapter 02)	JPY1.75 billion
4. Machinery and mechanical appliances (Chapter 84)	JPY1.68 billion
5. Pharmaceutical products (Chapter 30)	JPY0.69 billion

Three of the five categories above (electrical equipment, meat and machinery) have continually made the list for the past three fiscal years, and the remaining two categories (footwear and pharmaceuticals) made the list for the past two fiscal years.

Described below are the most commonly cited customs violations. In particular, abuse of the gate price system[44] for imported pork (i.e., intentionally declaring a fraudulent unit price for pork to obtain a lower customs duty rate) was among the top five most commonly cited customs violations every year for the past three years.

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[43] One billion is defined as one thousand million.

[44] Japan's gate price system for imported pork was discussed in the December 2015 issue of *TradeWatch*. According to the gate price system, if imported pork, priced at entry into Japan, is valued at or above the gate price, then the importer pays only the simple tariff rate. If the import value is lower than the gate price, the importer must pay the difference between the import value and the gate price as a duty, in addition to the tariff applied at the gate price value.

Case 1: Failure to report retroactive transfer pricing adjustments

An importer purchased medical equipment from a number of countries including the United States. The importer made an additional payment for the imported goods as a retroactive transfer pricing adjustment, but failed to file amended declarations to reflect the additional payment in the import price. As a result, the importer was found to have under-declared the import value by JPY19.89 billion, and was assessed an additional JPY1.17 billion in import taxes and penalties.

Case 2: Over-valuation of frozen meat

An importer imported frozen pork from various countries including Canada. The importer declared that it purchased the pork at a price close to JPY524 per kilogram, which resulted in the lowest customs duty amount under the gate system. However, the importer's actual purchase price, which was much lower than the declared value, should have been declared instead. As a result, the importer was found to have over-declared the import value by JPY1.75 billion, and was assessed an additional JPY2.36 billion in import taxes and penalties (including JPY612 million of penalties for gross negligence).

Case 3: Failure to report the costs of raw materials provided free of charge by the importer

An importer provided materials necessary for the production of personal health products to manufacturers in South Korea free of charge. Although the importer should have included the cost of such materials in the import price, it failed to do so.

Additionally, the importer failed to report other costs. As a result, the importer was found to have under-declared the import value by JPY897 million, and was assessed an additional JPY74.56 million in import taxes and penalties.

Case 4: Incorrect value declared on cargo with restrictions as to its disposition or use

An importer imported solar modules from a related Chinese exporter. The importer was able to purchase the products at a lower price on the condition that it resells such products to another group company. The importer paid a higher price for products for resale to third parties. As the former constitutes a restriction on the buyer's disposition of the goods, which affects the price of the goods, the importer should have declared the products purchased for resale to another group company at the higher price, but failed to do so. Additionally, the importer also failed to report other costs. As a result, the importer was found to have under-declared the import value by JPY9.3 billion, and was assessed an additional JPY629 million in import taxes and penalties.

Case 5: Import declarations based on falsified invoices

An importer imported dried seaweed from various countries including China. The importer was aware of the actual price before import, but requested the exporter to prepare invoices with a lower price, and in some cases, the importer created invoices with lower prices. The importer then went on to declare the customs value based on falsified invoices in an attempt to conceal the real transaction value. As a result, the importer was found to have under-declared the import value by JPY430 million, and was assessed an additional JPY83.9 million in import taxes and penalties (including JPY20.6 million of penalties for gross negligence).

The stakes for noncompliance are high and continue to rise

Currently, penalties of 10% to 15% levied on unintentional violations are waived if the importer voluntarily discloses under-declared tax before commencement of a customs audit, even if an audit notice has been issued. However, beginning 1 January 2017, penalties of 5% to 10% will be imposed where importers voluntarily disclose under-declared tax after the issuance of an audit notice, but before commencement of a customs audit. This is intended to encourage importers to make proper declarations in a timely manner rather than wait to receive an audit notice. Under the new measures, repeat offenders will be subject to an additional 10% penalty if the importer has records of non-declaration or of fraud/gross negligence within the past five years.

Focus on customs value

In Japan, many of the goods included in the top five categories of products subject to assessments are duty free, including many items of Chapters 30, 84, 85 and 90. However, as customs value is also the basis of import consumption tax, which is levied on all imported goods regardless of the customs classification, Customs closely scrutinizes the import declarations and payments made by such importers to ensure that they are declared in compliance with relevant customs laws and regulations.

All five of the commonly cited violations above relate to customs valuation, and indeed, Japan Customs auditors often focus on customs valuation. With the increase of Advance Pricing Agreements (APA) and other transfer pricing arrangements in recent years, Japan Customs has consistently taken the position that if retroactive pricing adjustments relate to the imported goods and the price is retroactively adjusted upward, the affected import declarations should be amended to reflect the adjustment. Customs also continues to pay close attention for potential additions to customs value, including royalty payments, research and development (R&D) costs incurred overseas, materials used in the production of goods, etc. If such payments are related to the imported goods, but are paid separately from the price of goods, they may need to be included in the import value of the goods. However, these payments are commonly overlooked, mainly due to the fact that the departments handling such payments are not aware of the potential customs implications and do not relay such information to the department responsible for filing import declarations.

As intercompany pricing and payments become more complex, it is becoming more and more important for companies to establish internal trade compliance programs and provide periodic training to relevant employees.

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European Union

Importers in the EU may soon be eligible to receive interest on refunded antidumping duties

National customs authorities in the EU may soon be required to pay interest on antidumping duties paid that are later reimbursed. According to an opinion delivered on 8 September 2016 by an Advocate General at the Court of Justice of the European Union (CJEU), when antidumping (AD) duties are reimbursed after annulment of the EU Regulation imposing them, the national customs authorities should also pay interest on the sums that were refunded from the date the AD duties were paid.

Advocate General Manuel Campos Sanchez-Bordona issued this opinion in the context of a dispute arising before a German Finance Court between German shoe retailer Wortmann and the German customs authorities (C-365/15).

After the CJEU annulled Regulation 1472/2006 that imposed definitive AD duties on imports of footwear from China and Vietnam, Wortmann submitted applications to the German customs authorities for reimbursement of any AD duties paid based on the annulled regulation. Wortmann also requested payment of interest on the sums refunded from the time Wortmann paid the AD duties. German customs reimbursed the AD duties, but refused to pay the requested interest citing as basis Article 241 of the Community Customs Code (Article 241).

According to Article 241 (replaced by Article 116 (6) of the Union Customs Code (UCC) as of June 2016), the refunding of customs duties does not trigger the requirement for the customs authorities to pay interest, except in the following two situations:

1. Where a decision to grant a repayment is not implemented within three months of the date that decision was adopted
2. Where national provisions stipulate that interest should be paid

The German customs authorities stressed that in the case at issue, the criteria laid down in Article 241 were not fulfilled as there had not been a delay of three months in implementing the reimbursement decision and German legislation only provides for a right to payment of interest from the date the request for reimbursements was filed with the courts.

After Wortmann challenged the German customs authorities' refusal to pay interest, the German Finance Court questioned whether Article 241 is compatible with the general principle of EU law, according to which, whenever the authorities are required to reimburse income received contrary to EU law, they should also pay interest from the date the undue payment was made.

The German Finance Court thus referred the question for a preliminary ruling to the CJEU on the interpretation of Article 241. The Finance Court asked, in essence, whether in light of the aforementioned general principle of EU law, Article 241 should not be interpreted as requiring the national customs authorities to pay interest from the date of payment of the AD duties.

According to the Advocate General, Article 241 should not apply to situations in which the reimbursement of AD duties is required because the EU regulation that imposed the duties has been declared invalid by a CJEU decision. The Advocate General reasoned that following the CJEU annulment of an AD regulation, the customs authorities are required to take the necessary measures to restore the situation that would have occurred had this regulation never existed.

Such measures encompass not only the reimbursement of the AD duties wrongly levied and paid, but also interests from the date the AD duties were paid.

If the CJEU follows the Advocate General's opinion, which is often the case, this could create a legal precedent that would entitle importers to receive interest on refunded AD duties from the date those duties were paid.

The newly adopted UCC could make this opinion even more relevant. This is because the new UCC, Article 116 (6), no longer includes the possibility where the obligation for the customs authorities to pay interest on refunded import duties is based on their national legislation.

The CJEU is expected to render its judgment in the beginning of 2017.

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Ivory Coast

Periods of prescription in customs matters

Because of the difficult economic situation of countries in the French-speaking Sub-Saharan Africa region, the customs authorities are under pressure to increase revenue collection. In some cases, the customs authorities are querying on past transactions for periods where government claims are time-barred. Importers who are aware of the various periods of prescription,[45] which limit the power of the customs authorities under customs law, are in a better position to respond to such inquiries. In this article, we focus on the periods of prescription in customs matters under the customs law of Ivory Coast.

Background

Section 229 of the Ivory Coast Customs Code provides that the Customs Administration may not request payment of customs duties and other import taxes two years after such duties and taxes should have been paid. This provision means that the importer is protected by a prescribed time limitation period of two years after the customs clearance transactions.

The two-year period of prescription starts to run ten business days following the day the customs duties and other taxes became payable.

The provisions regarding the prescription period for customs duties and taxes also apply to the imposition of fines.

Interruption of the prescription period

When the prescription period is interrupted, a new period starts to run from the date the interruption occurs. Some causes of interruption are discussed below.

The customs authorities have power under Section 220 of the Customs Code to assess taxpayers in all cases where a customs debt has been incurred. If the customs authorities notify the claim to the taxpayer within the two-year prescription period (which starts on the day the customs debt became payable), the new prescription period that starts following this interruption is 30 years.

Depending on the facts, the customs authorities may decide to take the matter to court for adjudication. A judicial summons as well as a conviction following judicial proceedings for violation of customs rules are causes of suspension of the two-year prescription. The new prescription period becomes 30 years.

[45] The period of prescription (referred to as the "statute of limitations" under common law) is the period after which public prosecution is no longer possible under the law.

Similarly, under section 229 of the Customs Code, where the importer signs a promissory note or a contract that provides the specifics of the commitment and the terms for payment of duties and other taxes owed also interrupts the prescription period.

Suspension of the prescription period

Fraud

In cases of fraud, there is a three-year prescription period that starts on the day when the fraud was discovered and is suspended (ends) after the three-year period elapses. Furthermore, proof that as a result of a fraudulent act, the customs authorities were not able to determine the exact amount of the duties payable, the prescribed time limitation period under section 229 is interrupted from the date the fraud was discovered.

Referral to an advisory body

Except for fraudulent acts by the taxpayer, there is no legal provision for suspension of the period of prescription for other reasons. However, in practice, the prescription period is suspended in the case of litigation that requires the opinion of an advisory body to decide certain contentious issues.

For example, where irregularities in the customs value are detected after an audit, during the customs clearance procedure or through ex-post controls, the opinion of the Arbitration Valuation Committee of the customs value is required under Law No. 05/99/UEMOA, section 13, implementing the customs valuation rules. Similarly, the Higher Tariff Committee's opinion is sought in a dispute regarding tariff classification. In these cases, the prescription period is suspended.

Periods of prescription related to the refund of duties and other import-related taxes

Importers may receive refund of customs duties and other taxes under Section 99 of the Customs Code in limited circumstances, as follows:

- Damaged or deteriorated released goods
- Defective or non-compliant with the order released goods
- Error on the part of Customs Administration regarding payment

Importers must request refund of customs duties and taxes or restitution of impounded goods from the Customs Head Office within two years after payment.

The period of prescription for impounded goods starts on the date when the receipt is issued for the payment of duties or the fine guaranteed by the impoundment.

Final thoughts

We have highlighted only certain aspects of the law on the periods of prescription as it applies to customs matters. It is important that companies doing business in Ivory Coast as well as the rest of the French-speaking Sub-Saharan Africa region become aware of their rights under the law and review whether the periods of prescription could have an impact on their business operations.

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Turkey

Is VAT on royalties payable to the customs authority or tax authority?

Companies with royalty agreements are often uncertain about how and where value-added tax (VAT) on royalty payments is to be paid. A recent Revenue Administration (Gelir İdaresi Başkanlığı, GİB or tax authority) ruling appears to offer a solution.

The uncertainty arises mainly from the fundamental difference between the way Turkish Customs and GİB treat VAT on royalty payments. While Turkish Customs takes the position that if an item is subject to customs value rules, the Customs authority should collect VAT, GIB argues that VAT on royalty payments should always be made to the tax authority as an intangible right. This fundamental difference in perspectives does not occur in areas such as customs duty, special consumption tax (SCT) and income tax withholdings. Problems arise only with respect to VAT on royalty payments that is added to the customs value because the same VAT becomes payable to two different authorities on the same royalty payment.

The customs authority's approach to royalty payments

The term "royalty" under customs law is defined as the "payments made under various titles such as patent, design, know-how, model, brand, proprietary design, copyright and manufacturing processes regarding the manufacture, export sales or use or resale of imported goods."

In terms of customs rules, it is not obligatory to declare every royalty payment to the customs authority. Only royalty payments that meet the two criteria below are required to be added to the customs value:

1. Royalty payments must be related to the goods whose value will be assessed.
2. Royalty payments must be made on condition that these goods are sold.

Customs promulgated Communiqué no. 2 dated 28 June 2014 to present Turkish Customs' approach to royalty payments. Accordingly, if VAT has been paid to the tax authority under the VAT 2 return, Turkish Customs does not charge VAT again. In other words, Turkish Customs takes into account the VAT paid to the tax authority. However, in that case, the Customs authority imposes an irregularity fine of TRY89 for 2016 (approximately USD26.50) under Customs Law no. 4458 for each customs declaration where VAT is paid to the GİB instead of to customs. Thus, payment of VAT on royalty payments to GIB is, in a way, penalized by the customs authority. Companies with intensive import transactions incur significant costs due to this practice.

The tax authority changes its approach

Recently GİB issued Tax Ruling no. B.07.1.GİB.4.34.17.01-KDV.1-13147 dated 17 February 2016 (the Ruling) on the tax system. According to the Ruling, if VAT due on a royalty fee is paid to the customs authority, the amount to be declared in the scope of liability under VAT return no. 2 will be the amount remaining after the deduction of the amount declared and paid to customs. Apparently, the objective of the Ruling is to prevent double VAT payments by ensuring that GİB takes into account VAT paid to the customs authority.

Before this Ruling, the tax authority did not accept the deduction of VAT on royalty payments, even if VAT had been paid to the customs authority. Many companies preferred to pay VAT to both Turkish Customs and the tax authority in a single invoice on the same item, rather than risk a customs irregularity fine for each customs declaration where the importer selected the tax office as the recipient of the VAT payment.

Implications for importers

Importers are advised to evaluate their payment procedures and if applicable, take advantage of the latest regulatory developments to avoid double taxation on their royalty payments.

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Uganda

Managing customs post-clearance audits

Background

The Uganda Revenue Authority has become increasingly aggressive in conducting post-clearance audits (PCA) to recover taxes and penalties from importers. As a rule, the importer of the goods is responsible for any errors made by licensed customs brokers that result in noncompliance with customs law and procedures. Notably, it is only licensed customs brokers, acting on behalf of importers, who may make declarations of taxes to be paid on all imports through a self-declaration/assessment system.

Businesses and individuals involved in importation activities are required to pay several customs taxes including import duties, value-added tax, withholding tax, excise duty (on selected imports) and others, such as the environmental and infrastructural levy.

A typical PCA involves the review of importer records (relevant customs documentation, commercial documents, business systems, etc.) sometime after importation to verify compliance with customs laws and regulations and to ensure that the proper amounts of duties and related taxes have been paid.

Since customs clearance of imported goods is largely completed through the self-declaration and self-assessment mechanism, the Uganda Revenue Authority conducts periodic PCAs and tends to focus on large/regular importers of goods into Uganda and their compliance history.

The objectives of a PCA include:

- To establish whether the importer declared the correct values to customs at the time of clearance of the goods
- To verify whether the imported items were classified correctly and the appropriate Customs Procedure Codes (CPCs) applied at the time of customs clearance
- To establish whether goods declared as originating from the East African Community (EAC) or Common Market for Eastern and Central Africa (COMESA) regions where correctly declared to Customs
- To confirm that appropriate taxes were assessed and paid

Preparations prior to a PCA

As the Uganda Revenue Authority always gives notice before conducting a PCA, the importer has an opportunity to prepare adequately for the audit. Importers should undertake regular reviews and health assessments of their import operations well in advance of a PCA. All requisite information should be presented in an organized and easy-to-access format. It is also important to note that taxpayers should share only relevant information with the auditors as providing unnecessary information may lead to confusion, additional queries and a protracted audit process.

The audit team often chooses to conduct a field audit from the taxpayer's premises. As part of the adequate preparation for the field audit, the importer should make available full-time support and liaison staff to assist the auditors. Preferably, the support staff should be a company officer who is conversant with all aspects of the business (especially financial, logistical and importation processes) and competent enough to respond to any queries raised and clarifications sought by the auditors.

Information flow management

The management of information flow between the importer and the auditors is key to having a successful audit. During the audit process, importers are expected to provide information to the auditors within short deadlines. This may cause some importers to provide information that is incomplete, inaccurate or unverified and risk having the auditors make the audit findings on such information.

Engagement with the audit team of the initial audit findings

As soon as the auditors complete and document their initial audit findings, the importer is given an opportunity to respond through Reconciliation meetings where the importer may present his or her position along with the requisite supporting documentation. This Reconciliation stage is critical as it precedes the issuance of a tax assessment by the Uganda Revenue Authority.

A successful Reconciliation stage for the importer could mean a lower tax assessment than earlier projected by the initial audit findings.

Objection, review and appeal procedures

In case the importer is dissatisfied with the additional tax assessment, he or she has the right to apply to the Commissioner for review of the tax assessment or any other tax decision/omission made within 30 days from the date of the assessment or decision/omission. The Commissioner of Customs will communicate his or her decision in writing within 30 days from the date the importer's application for review is received. If the importer is still dissatisfied with the Commissioner's review, the importer can appeal that decision to the Tax Appeals Tribunal for further review. The appeal should be lodged within 30 days from the date the Commissioner's decision was communicated to the importer.

In practice, some importers fail to exhaust the objection, review and appeal procedures to their advantage. These procedures should be explored within the strict time limits provided by the law; otherwise, the importer may have to pay all the additional taxes on demand by the Uganda Revenue Authority.

Conclusion

The customs authorities are aggressively ensuring compliance through more frequent PCAs and most of them yield high tax collections. Companies found to be noncompliant risk paying additional taxes and penalties.

Furthermore, finding a taxpayer noncompliant may affect the company's risk rating and hence, lead to increased scrutiny of its imports by the customs authorities. Where results of the PCA indicate noncompliance, the taxpayer also risks losing certain incentives such as the exemption from Withholding Tax on imports.

Therefore, it is important that PCAs are well managed and any issues of noncompliance resolved preferably prior to the audit. Regular customs tax reviews may be especially helpful to large importers who are the most common targets of PCAs.

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Ukraine

Ukraine has launched Single Window

In August 2016, Ukraine introduced the Single Window for handling procedures and formalities related to the cross-border movement of goods. This solution is expected to streamline customs clearance, combat corruption and facilitate the processing of goods under various controls (sanitary, veterinary, phytosanitary, ecological and radiological) and regulatory requirements upon import and export.

Where Single Window is available, an economic operator does not need to apply to each controlling authority and receive paper-based permits. The authorities now have the capability to execute any relevant controls electronically through the Single Window.

Ukrainian Customs acts as an entry point for the Single Window and is in charge of developing the web-based platform that brings together government agencies and traders. The Single Window service is completely free of charge. The authorities must issue all import or export approvals and licenses within four hours, which is now the statutory limit for customs clearance. If the authorities fail to either grant or deny a permit within four hours, the system will issue a permit automatically.

At this stage, use of the Single Window is not mandatory and economic operators may elect to use paper-based controls. Although the current number of traders using the Single Window is relatively low (about 1% of all incoming shipments), it is increasing and certain customs offices already release more than 40% of all goods using the Single Window.

To enable fully-fledged implementation of the Single Window, the Ukrainian Government is now considering further changes to legislation and administrative procedures (e.g., introduction of risk-oriented controls, reduction of the types of goods subject to state controls and the quantity of documents required for such controls).

If successful, this project will make import and export procedures significantly easier. Even before the Single Window is fully implemented, companies doing business in Ukraine may need to reconsider their business processes so they can take advantage of the streamlined customs procedures and avoid delays.

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