

TradeWatch

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Spotlight on

Customs-transfer pricing developments in the United States

US Customs finalizes ruling allowing transfer pricing adjustments



U.S. Customs and Border Protection (CBP) has adopted a policy first proposed in September, which accepts transfer pricing adjustments provided that specified conditions are met. In the December 2011 and March 2012 issues of *TradeWatch*, we reported on the development of this proposed policy. On 30 May 2012, CBP formally adopted the policy by revoking a prior CBP ruling and replacing it with a new ruling that allows post-importation customs value adjustments made pursuant to a transfer pricing policy, provided that:

1. The transfer pricing policy meets specific criteria stated in the CBP announcement (noted below).
2. The importer can demonstrate that the transfer pricing policy results in arm's-length pricing under customs-specific tests.

Background

Importers into the US that purchase products from related parties quite often base their transfer pricing on targeted profit margins. To the extent the financial results for a period (often the fiscal year) are within the targeted range, no additional action is taken. When profits are outside the targeted range, a retroactive adjustment to the purchase is made to bring the profits into the range. This action by CBP provides a path forward for importers using this approach, allowing them to treat the purchase price, as it may be adjusted, as transaction value. This includes a clear process for receiving refunds of customs duties paid when prices are adjusted downward.

Five factors specified

The final ruling follows the general approach taken in the two previously published advance notices. The final ruling does clarify the list of five factors that CBP will use to determine that a transfer pricing adjustment is consistent with transaction value. The factors are:

- "1. A written "Intercompany Transfer Pricing Determination Policy" is in place prior to importation and the policy is prepared taking IRS code section 482 into account;
2. The US taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
3. The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted;
4. The company maintains and provides accounting details for its books and/or financial statements to support the claimed adjustments in the United States; and
5. No other conditions exist that may affect the acceptance of the transfer price by CBP."

Reconciliation "strongly encouraged"

The final announcement also states that "importers are strongly encouraged" to use the CBP Reconciliation Program to report adjustments. From a practical standpoint, however, importers may have no other choice. The ruling goes on to state that if importers claim adjustments outside of reconciliation, "they are expected to demonstrate at the time of entry that the price is arm's length and to provide supporting documentation." On its face, this statement seems incompatible with transfer pricing adjustments made pursuant to profits-based transfer pricing methods.



Multiyear adjustments

Finally, the ruling leaves open the possibility of dealing with adjustments made pursuant to Advance Pricing Agreements, which require adjustments on a multiyear basis. A footnote in the ruling states that adjustments made on a yearly or quarterly basis are “more acceptable,” and that importers must show that a multi-year adjustment is compatible with transaction value.

Implications for importers

US importers that base transfer prices on profits-based transfer pricing methods should take specific actions:

1. **Prepare customs-specific supporting documentation.** CBP clearly states that the new policy deals only with reporting adjustments made pursuant to transfer prices, which are otherwise acceptable for customs purposes. The policy does not mean that CBP will accept transfer pricing studies as support for customs value. Because the proposed policy will make adjustments easier to make, including adjustments that would result in customs refunds to taxpayers, it is more important than ever that taxpayers supplement transfer pricing studies with customs-specific supporting documentation.
2. **Apply for the Reconciliation Program.** As explained above, the new policy is intended to apply to importers using the CBP Reconciliation Program. Reconciliation allows an importer to declare a provisional value at import, and adjust to the final value up to 21 months following import. Importers must be approved to use the Reconciliation Program in advance of the imports, whose value may be later adjusted. All importers contemplating transfer pricing adjustments should apply for reconciliation in order to benefit from the new policy.
3. **Supplement transfer pricing policies.** As noted above, there are five specified criteria to use the new policy. A clear statement of each, as a part of or as an addendum to existing transfer pricing documentation, is a prudent action for any impacted importer.

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Global implications of the US Foreign Sanctions Evader Program



Overview

As part of a continuing effort to escalate economic pressure against the Iranian and Syrian regimes, President Obama issued a new executive order (EO) “Prohibiting Certain Transactions with and Suspending Entry into the United States of Foreign Sanctions Evaders with Respect to Iran and Syria,” on 1 May 2012. This “Foreign Sanctions Evader” executive order (FSE EO) is a significant development in that it marks the first time the US government has made the evasion of US regulation a basis for the imposition of economic sanctions. Following on the heels of the Comprehensive Iran Sanctions Accountability and Divestment Act (CISADA) and Section 1245 of the National Defense Authorization Act (NDAA), this authority also represents an intensifying use of what some consider “secondary” sanctions – programs that impose countermeasures against foreign persons for dealings with parties subject to US sanctions.

What is covered by the FSE EO?

Complicated even by Office of Foreign Assets Control (OFAC) standards, this new program gives OFAC the authority to impose sanctions against foreign persons who:

- ▶ Violate, attempt to violate, conspire to violate or cause the violation of Iran- or Syria-related executive orders
- ▶ Facilitate deceptive transactions for or on behalf of any person subject to Iran- or Syria-related executive orders, or
- ▶ Are owned or controlled by, or are acting for or on behalf of, persons determined to meet the above criteria

These Iran- and Syria-related executive orders include both list-based programs targeting, among other things, designated terrorists, weapons proliferators and human rights abusers as well as government entities subject to blocking under the respective country blocking programs.

This program is unique in several respects. First, it carries no blocking or asset freezing requirement. Identified persons (note the use of the term “identified” rather than “designated”) are cut off from dealings with US persons, including US financial institutions. Accordingly, financial institutions must reject rather than block affected transactions, and businesses involved in international trade must refrain from dealings with listed parties. Financial institutions must also restrict accounts held for listed persons, not because the account is blocked, but because allowing its normal operation would constitute a prohibited export of financial services. (The lack of a blocking requirement in a list-based program is unusual and perhaps reflective of a desire to temper the impact of a regime that many, particularly overseas, will view as extraterritorial.)

Second, the FSE EO allows OFAC to target individuals and entities that have “facilitated deceptive transactions” – defined as any transaction where the identity of the person subject to US sanctions has been withheld or obscured – for designated parties even if it cannot be established that the underlying purpose of this suspicious activity was, in fact, sanctions evasion. In other words, from an evidentiary standpoint, evasive intent can be imputed to any deceptive transaction, giving OFAC significant targeting flexibility.



Why is the FSE EO necessary?

In its frequently asked questions (FAQs), OFAC states that the new program “expands Treasury’s ability to address the behavior of foreign persons determined to have violated or attempted to violate US sanctions... where the foreign person had no physical, financial, or other presence in the United States and did not submit to US administrative proceedings.” OFAC further explains that it may use this authority where it “appears that a foreign person violated US sanctions on Iran or Syria but may not meet criteria for designation under existing executive orders.”

This guidance suggests that a primary purpose of the FSE EO is to create leverage against foreign persons who may otherwise have little incentive to halt dealings with sanctioned parties either because such transactions are permissible under local law or because they have no connection to the US financial system. It appears that OFAC’s (not unrealistic) hope is that foreign sanctions evaders might choose to halt their activities and cooperate with US investigations when faced with the prospect of US blacklisting and the attendant reputational and commercial damage it often entails. The order’s lack of an annex containing an initial tranche of names reinforces the view that the primary goal of the new program is broad leverage and deterrence rather than proactive targeting.

Some might note that Iran- and Syria-related EOs already contain provisions allowing for the designation of persons who “act for or on behalf of” designated parties – language that could be interpreted as covering sanctions evasion. While OFAC’s authority to interpret “acting for or on behalf of” is broad, OFAC may have considered that its internal evidentiary standards – which are quite rigorous – could not be “stretched” to cover evasion, thus necessitating a new authority.

Who might be targeted?

However Treasury intends to use this new authority, whether as a diplomatic or a targeting tool, one thing seems clear – it will be used. Against exactly whom is an open question. OFAC provides some clues in its FAQs when it draws special attention to foreign persons lacking a US nexus. So it is unlikely that the FSE EO will target foreign financial institutions or other businesses with a US presence or interests, as these entities are already within reach of US enforcement. Rather, OFAC will likely take action against smaller non-bank financial institutions such as money service businesses and currency exchanges as well as trading companies in the Middle East and Gulf regions known to facilitate Iranian economic activity.

What does this mean for business involved in international trade?

For businesses that have a presence or significant interest in the US, the FSE EO probably does not mean too much, as US businesses do not appear to be the primary target for this authority. Certainly, businesses involved in international trade will want to remain vigilant when dealing with counterparties posing higher levels of Iran and Syria risk. But until OFAC adds specific names to the Specially Designated Nationals (SDN) lists, there are no direct obligations.

Most businesses involved in international trade perform screening either manually or through an automated solution to ensure that they are not dealing with restricted or denied parties, such as those on the SDN list. Given the frequency with which OFAC is making additions to the SDN list, businesses must have procedures in place to ensure that their screening programs are using the most current SDN-list. A leading practice is to test your screening program shortly after the lists are updated. Based on our experience assisting multinational companies with such testing, this is an area of vulnerability even when list updating services are provided by a third-party vendor.



List screening can only get you so far, however. Once designated, few sanctions evaders will continue to operate in their own names. Other cut-outs and middlemen will soon surface. The basic “blocking and tackling” of a strong export compliance management program can help mitigate the risk of being victimized by this activity. For example, when dealing with jurisdictions that present a higher-risk of re-export to Iran or Syria (such as those in close geographic proximity), it might be prudent to subject potential sales to enhanced due diligence concerning end-use and the involvement of other unforeseen parties. Key questions to consider include: Is the customer evasive concerning end-use? Does the customer seem familiar with the product? Is the product consistent with his/her line of business? These simple questions can help a company avoid costly investigations, fines and reputational damage.

Conclusion

Over the last year, the remaining “loopholes” in the US Iranian and Syrian sanctions programs – the lack of a comprehensive government asset freezing – have been closed. There is simply no more blood to be squeezed from the domestic sanctions stone. Going forward, the primary way to exert additional pressure on Iran and Syria is to impose costs on foreign persons that continue to do business with sanctioned parties. And, to date, the primary means of doing so have been through congressionally imposed statutory programs like CISADA and NDAA. The FSE EO represents the administration’s first independent foray into the secondary sanctions arena. While only time will tell whether Treasury will use this authority more as a deterrent (as it has in the cases of CISADA and the NDAA) or as an active targeting program (as it has with most Iran- and Syria-related EOs), it is clear that an important new threshold has been crossed in the use of economic sanctions.

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A big win for security-certified traders in the US and EU



On 4 May 2012, CBP and the EU Taxation and Customs Union Directorate signed the mutual recognition decision. This decision formally recognizes the compatibility of each other's security-certified trader programs, i.e., the US Customs-Trade Partnership Against Terrorism (C-TPAT) program and the EU's Authorized Economic Operator (AEO) program. According to the European Commission press release, the US and EU will start implementing the decision from 1 July 2012.

This mutual recognition decision is a big win for US and EU companies that are certified under these programs, as both customs authorities will treat each other's certified traders the same way as they do their own. These companies thus benefit from advantageous customs procedures, which are designed to reduce costs and border delays with greater ease and predictability in the movement of goods into these large markets. Additionally, these companies benefit from risk avoidance, due to the stringent security processes and internal controls required under the programs, and credibility with supply chain partners, which can open up new business opportunities.

C-TPAT already boasts more than 10,000 members and is mutually recognized by Canada, Japan, Jordan, Korea and New Zealand, while negotiations continue with Singapore. The EU AEO program is growing with approximately 5,000 current members and mutual recognition agreements with Switzerland, Norway and Japan as well as discussions underway with China.

This latest development demonstrates the momentum for the globalization of supply chain security standards and is a big step forward for companies looking to conduct trade with end-to-end supply chain security and speed. For companies considering applying for C-TPAT or AEO status, the upcoming implementation of the mutual recognition decision adds to the advantages of being a security-certified trader in the global marketplace.

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Argentina

Sensitive information required for import documents



The Argentine customs authorities are expanding the required data that importers must provide when filing import declarations. The latest requirement affects foreign suppliers, which must provide their tax identification number, a sensitive data requirement, in order for importers to be able to complete the import transaction.

In April 2012, the Argentine customs authorities explained in a meeting with foreign trade operators that they would create a mechanism in Sistema Informático María (SIM), the customs Information Technology (IT) system that requires the tax identification number of the foreign supplier when documenting an import transaction into Argentina. Without the foreign supplier's Tax ID number, the SIM will not perform the registration of the imports, thereby delaying customs clearance. This new mechanism has been in force since 1 May 2012.

According to the customs authorities, this new information would be fed into the risk management systems of the tax and customs authorities in the current environment characterized by agreements for tax and customs assistance and information exchange with other countries. The customs authorities have reasoned that this new information requirement is consistent with similar requirements adopted by other customs administrations in the region, and will help as an additional element to perform investigations and audits.

The new information requirement adds to the already long list of data required by the Argentine customs authorities. As set out in General Resolution 2793/2010, importers must submit a variety of documentation, including the commercial invoice, transport documents and certificate of origin. In particular, it is stipulated that the commercial invoice must include, among others items, the following details: statement indicating "original invoice," invoice number, name and address of seller and buyer, quantity and description of the goods, unit price, currency and Incoterm, among other items. The seller's tax identification number has now been added to the mix.

For foreign suppliers, this new requirement means that the company's tax identification number is effectively made available to the Argentine customs and tax authorities. Many companies may consider the tax identification number as sensitive company information that generally should not be required in such basic documents. This development adds to the growing list of recent measures in Argentina that serve to intensify the customs control.

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Brazil

Bigger Brazil's new trade defense measures



Despite the global economic crisis that continues to affect developed countries, Brazil has been able to sustain growth. The country's large and dynamic domestic market has brought significant foreign investment and resources and, as a result, the Brazilian government is now dealing with growing international competition locally as well as abroad.

In response, the Brazilian government of President Dilma Rousseff has implemented "Plano Brasil Maior" or "Plan Bigger Brazil" last August. This initiative represents a set of economic and tax measures designed to protect the national industry and promote growth within the domestic manufacturing sectors. The latest foreign trade measures implemented under the Bigger Brazil plan are focused on regulating and improving tax relief on exports, trade defense, financing and guarantee for exports and trade promotion.

The most significant measures issued thus far are focused on trade defense to defend domestic producers against unfair foreign competition. We highlight some of these recent actions below.

Changes to the Brazil-Mexico free trade agreement for the automotive industry

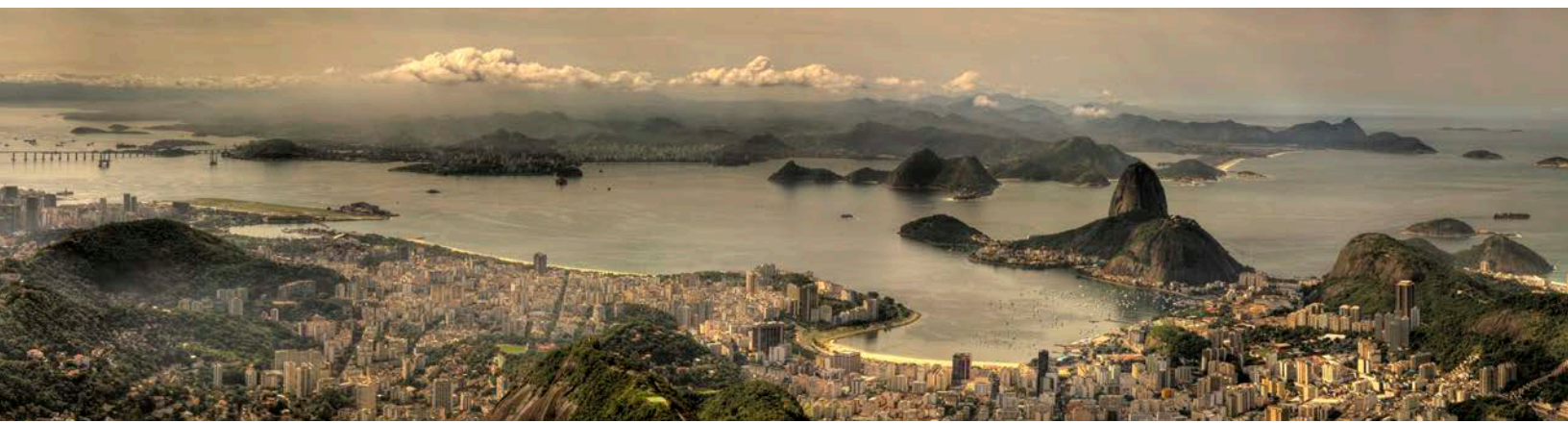
According to the Ministry of Industry, Commerce and Foreign Trade, Brazilian imports of Mexican vehicles rose 40% in 2011 from the previous year to more than US\$2 billion in value. At the same time, Brazilian vehicle exports to Mexico totaled only US\$372 million.

The Mexican auto imports have benefitted from import duty exemptions pursuant to the Brazil-Mexico free trade agreement signed nearly a decade ago, when Brazil's auto industry was not well developed and, at that time, could not sufficiently supply the domestic market. Since then, the Brazilian automotive industry has evolved and the government is concerned that the local industry, which is subject to many internal taxes, is detrimentally affected by the Mexican imports that have access to beneficial tax treatment.

Accordingly, Brazil has been undergoing negotiations with Mexico that have resulted in the reformulation of key provisions under the free trade agreement. New import restrictions with respect to Mexican auto exports to Brazil have been established by means of a progressive quota. The quota consists of pre-determined annual value amounts of Mexican vehicle imports to Brazil over the next three years as follows:

- ▶ US\$1.45 billion until March 2013
- ▶ US\$1.56 billion until March 2014
- ▶ US\$1.64 billion until March 2015

Other changes relate to the regional content value of the Mexican vehicles, which shall increase from 30% to 40% over the next five years. The progressive increase schedule provides for 35% from March 2013 and 40% from March 2016.



Safeguard investigation for wine industry

Due to the steady growth in import sales of foreign wine in Brazil, domestic wine producers are pushing for safeguard measures against wine imports. In response, the Brazilian government has opened an investigation to determine whether safeguard measures are necessary. The outcome is uncertain considering that Brazilian wine producers currently cannot meet domestic supply needs in terms of both quantity and quality, and would need to invest in technology and infrastructure to enhance production capabilities. However, if the investigation finds that wine imports are damaging local producers, an import quota and increased import duties would likely be imposed.

Public consultation to increase certain import duty rates

Another trade defense measure resulting from the Bigger Brazil plan is the opening of public consultation to enable companies or associations to suggest products that should be subject to a temporary import duty increase as a measure to protect and develop domestic industry. Public comments, which were submitted to the Brazilian authorities in April, are currently under review by the Brazilian Foreign Trade Commission. The import duty increases will be valid for one year with the possibility to extend an additional year.

Closing thoughts

The trade defense measures of the Bigger Brazil plan signal an increase in protectionist policies despite the global push for a reduction in trade barriers. Rather, Brazil is leaning toward the restrictive trade regime of the past. By changing its economic and trade policies once again, Brazil is sending mixed signals to foreign investors and its trading partners. With a renewed focus on trade defense, Brazilian importers will need to closely follow these developments and be prepared for changes that could increase the indirect tax burden.

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Canada

Canada's 2012 federal budget – implications for customs and trade



The Canadian government recently released the federal budget for 2012 (Budget 2012), which includes a variety of customs measures and trade initiatives. We highlight below some customs tariff measures that have already taken effect, as well as areas to watch, which include initiatives designed to expand trade opportunities and streamline safeguard measures to benefit business in the near future.

Customs tariff measures affect the energy industry and travelers

Budget 2012 contained relatively few customs tariff measures. Nonetheless, the budget will eliminate the 5% most-favored-nation rate of duty imposed on certain imported oils used in oil and gas refining as well as electricity production. This tariff elimination, implemented through amendments to Canada's customs tariff, applies to goods imported after 29 March 2012. This tariff measure essentially re-instates the duty-free status for the subject fuel oils (e.g., fuel oils No. 5 and No. 6) that had been previously "recharacterized" by the Canada Border Services Agency due to their viscosity.

In addition, Budget 2012 also increases some of the existing personal exemptions under the customs tariff that permit returning Canadian residents to import goods valued up to particular limits on a duty-free basis. The limits are based on the length of time during which the resident has been absent from Canada. Specifically, for absences of 24 hours or more, the travelers exemption has increased from CA\$50 to CA\$200. For absences of 48 hours or more, the travelers exemption has increased from CA\$400 to CA\$800. These new levels, which took effect on 1 June 2012, have replaced the previous exemption of CA\$750 for Canadian travelers who have been abroad for seven days or more. We note that the existing lack of duty exemptions for residents returning to Canada after less than 24 hours abroad and the personal importation limits on alcohol and tobacco products remain unchanged.

Areas to watch

Expansion of trade and investment opportunities with priority markets

Budget 2012 emphasizes plans to deepen trade and investment opportunities with Canada's trade partners and certain high-growth "priority markets." The government is in the process of updating its global commerce strategy, which will provide further details on the markets Canadian trade and investment initiatives will be focusing on in the near future.

Streamlining of trade remedy system

Budget 2012 aims to significantly change Canada's trade remedy system in order to streamline processes. The current system is administered jointly by CBSA and the Canadian International Trade Tribunal (CITT). Through legislation, the government plans to consolidate the investigation functions under the CITT. This significant change aims to reduce red tape and make it easier for businesses to implement safeguard measures against unfairly traded imports.

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

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Peru

New guidance from Peru on the customs treatment of royalty payments



The customs treatment of royalty payments is a controversial issue for global traders in most jurisdictions and Peru is no exception.

Peru adheres to the World Trade Organization (WTO) Valuation Agreement, which provides that royalties paid by the importer of a product to someone other than its seller must be added to the price paid for such product in order to determine transaction value when the royalty:

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

While the World Customs Organization (WCO) provides some guidance with respect to the application of these conditions to import transactions, much remains open to local interpretation (see the article “WCO approves commentary on royalties but controversy remains unsettled” in the December 2011 issue of *TradeWatch*). Below we discuss some recent Peruvian Customs Administration rulings and Tax Court resolutions that provide guidance in such regard.¹

“Condition of sale” determination

Customs authorities around the world have different interpretations as to how to determine if a royalty must be paid as a condition of sale. Generally, in making this determination, it is important to examine all the relevant documents, including the royalty or license agreement and sales agreement. While customs authorities agree that the condition of sale exists in case of a contractual provision in the sales agreement that requires the payment of the royalty in order for the seller to sell product to a buyer, there is disagreement on whether, and how, a condition of sale may be implied when no contractual condition exists.

In recent rulings, the Peruvian Customs Administration has addressed the condition of sale determination with respect to royalty payments paid to a related third party. Instead of focusing on the facts and circumstances of the sale and importation of the goods, such as the terms of the contractual agreements, the Customs Administration focused only on the relationship between the parties. Basically, the Customs Administration has taken the position that the condition of sale requirement is automatically met when the importer and either the licensor or manufacturer (but not necessarily both) are related and no further analysis is required.

The Customs Administration supported its decision based on the WCO Technical Committee on Customs Valuation Advisory Opinion 4.11. In this opinion, a dutiable royalty existed when the importer, manufacturer and parent company (trademark holder) were related, even though there was no contractual agreement requiring the importer to pay the royalty to the parent company.

However, the Peruvian Customs Administration made this determination despite the fact that in some cases, the specific purchase agreement, as well as other commercial information, expressly stated that the royalty payment was not considered as a condition of sale and the applicable resolution clause did not foresee the absence of payment for the royalties as a breach of the agreement.

In our opinion, the WTO Valuation Agreement and related guidance do not advance such a strict interpretation in determining an implied condition of sale, yet the Peruvian Customs Administration has taken an aggressive approach in this respect.

¹The subject rulings are based on the binding opinion from a general case.



Relation to the imported product

Both the Peruvian Customs Administration and the Tax Court have been issuing adjustments to the customs value of imported goods for copyrights, trademarks and other undeclared intangibles considered to be related to the imported goods in a wide range of cases. The authorities have applied these adjustments based on an affirmative determination of the “condition of sale” requirement; however, in some cases, the relation of such intangibles to the imported goods has not been properly analyzed.

As a result, payments for “know how” or “technical assistance,” without a clear relation with the imported products, have been considered as dutiable royalties or license fees by the Customs Administration. The basis of such position is that the royalties or the transfer of special technical knowledge is related to the imported goods, as it is needed in order to develop, produce and manufacture the finished product locally. This interpretation has led the Customs Administration to treat the royalty computed on the resale price of a finished product as an addition to the value of an imported raw material or input.

This position seems inconsistent with the WTO Valuation Agreement, which provides that the royalty adjustment must be related to the goods subject to valuation (i.e., the imported goods). Accordingly, if the intangible payment is related to products other than the imported items, it would not be “related to the imported products” and no adjustment to the customs value of the goods would be required.

Implications for business

Based on these recent rulings, importers – particularly when dealing with related parties – should expect additional scrutiny with respect to royalty, license fee and related payments. Affected importers should assess any potential exposure for undeclared payments and consider corrective actions or be prepared to respond to customs inquiries. Any positions that focus only on guidance issued by the WTO Valuation Agreement or WCO instruments should take into consideration the Customs Administration’s latest interpretation and be wary of the exposure risk.

Finally, we would like to point out that the Peruvian Customs Administration as well as the Tax Court has also issued specific rulings on other customs valuation adjustments, such as engineering fees, that have a great impact on specific contracts (e.g., engineering, procurement and construction contracts). We will address these specific rulings in future issues of *TradeWatch*.

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Mexico

Electronic filing of customs information now mandatory in Mexico



Effective 1 June 2012, Mexico's new electronic foreign trade platform, Ventanilla Digital Mexicana de Comercio Exterior (commonly referred to as Ventanilla Única) has become mandatory for customs clearance. Paper entry forms and related customs filings are no longer accepted.

The Ventanilla Única was established by decree in January 2011 as a single electronic platform to allow foreign trade operators (i.e., importers, exporters, customs brokers, etc.) to file electronically all foreign trade information required by the Mexican authorities. The electronic platform aims to automate and standardize customs processing, thereby reducing time for customs clearance, reducing storage costs and improving customs risk analysis with advance information. The move to a paperless customs environment was originally scheduled for 1 March 2012, but was delayed until 1 June.

Now, all import and export entry documentation, which used to be physically presented to the customs office before the goods could be imported into Mexico, must be filed electronically. These filings include the import entry declarations as well as supporting documentation (e.g., commercial invoice, certificate of origin) and other documentation necessary to obtain authorizations and import permits, and to meet all other foreign trade-related requirements.

Mexico's move to a paperless customs environment has significantly changed the customs clearance process and the way companies conduct trade. Considering Mexico's relatively fast transition to an electronic environment, importers have had to adapt quickly to develop the necessary IT capabilities and update internal processes. Considering the importance of the advance customs data for risk profiling, it is important that companies also assess internal controls to improve the accuracy and availability of advance data or risk supply chain disruption.

Additionally, companies should keep in mind that as Mexico continues to adapt to the electronic environment, modifications to existing data requirements are likely. For instance, the required commercial invoice data elements are currently under consideration. Accordingly, Mexican importers and their supply chain partners need to monitor changes and be prepared to implement any new requirements quickly.

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Registrations for Mexico's Authorized Economic Operator Program are starting



As detailed in our previous (March 2012) issue of *TradeWatch*, Mexico has reorganized its certified company program (*Empresa Certificada*) to create a new AEO program, known as *Nuevo Esquema de Empresa Certificada* (NEEC). Company registrations are starting, albeit at a slow pace, which is an indicator of the time and effort necessary to gain (or maintain) the most advantageous trade facilitating benefits under the new NEEC regime.

Mexico's new AEO program – recap

The NEEC program adds a supply chain security element to the *Empresa Certificada* program, which is consistent with the World Customs Organization's SAFE Framework of Standards to Secure and Facilitate Trade, and is similar to the US C-TPAT, Canada's Partners in Protection and other AEO programs across the globe.

NEEC status is important for Mexican importers because the primary *Empresa Certificada* benefits are now limited to approved companies that meet the higher compliance and supply chain standards required under NEEC. These benefits include:

- ▶ Regularization of goods after an audit has been initiated
- ▶ Use of "express" lanes for customs clearance
- ▶ Use of PROSEC preferential duty rates upon change of regime
- ▶ Virtual transfers of goods to Mexican residents (applicable to IMMEX operations)

In order to register under the NEEC program, companies have to obtain a favorable ruling from the Central Administration of International Affairs (CAIA) after completing a "company profile," which includes information on companies' standard operating procedures and documented processes regarding supply chain security planning, internal audits, physical security of the facilities, physical access controls, criteria for selecting commercial partners and logistical process mapping, among others.

The CAIA may take up to 100 business days to issue a response to the ruling request. The response time may be significantly reduced if the company's facilities are already registered under C-TPAT and such information is shared with CAIA. Once the favorable ruling is obtained, a renewal request must be filed before the Central Regulatory Administration of the Tax Administration, which may take an additional 40 business days, before the final authorization to participate under the NEEC program is obtained.

Current status

As of May 2012, approximately 15 applications for the NEEC ruling have been filed before the CAIA and only two of them have been approved. It is important to note that currently, there are approximately 1,000 companies that are actively operating under the *Empresa Certificada* program. Accordingly, the number of applications is expected to rise drastically once these companies complete the laborious process of requesting authorization to operate under the NEEC program in order to maintain the higher level of customs benefits.

Companies currently benefiting from the former *Empresa Certificada* program should not delay preparations for their renewal under the NEEC program. Safeguarding primary customs benefits and the competitive advantage that comes with them depends on the company's ability to effectively adapt to NEEC.

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United States

US Customs and Border Protection announces expansion of the Centers of Excellence and Expertise Program



CBP recently announced the expansion of its Center of Excellence and Expertise (CEE) program.

CEE program overview

CEEs are part of a larger CBP initiative called "Trade Transformation." Trade Transformation seeks to improve cargo security while increasing trade competitiveness by fully aggregating risk management. CBP plans to accomplish these goals by following the "BEST" acronym:

- ▶ Better targeting
- ▶ Expedite trade
- ▶ Segment risk
- ▶ Transaction savings

The CEE program's goal is to facilitate trade by increasing uniformity and transparency of practices, increasing overall port safety, and decreasing the time it takes to resolve compliance issues by centralizing industry expertise in one location. CEEs were first established in 2011 as part of a CBP strategic initiative to enhance benefits for "trusted traders" while increasing the agency's oversight over some of the largest US importers. The industry-based centers, listed below, have grown quickly with two new centers added in May 2012.

- ▶ Electronics Center – Long Beach, California
- ▶ Pharmaceutical, Health & Chemicals Center – New York, New York
- ▶ (New) Automotive & Aerospace Center – Detroit, Michigan
- ▶ (New) Petroleum, Natural Gas & Minerals Center – Houston, Texas

Each established center serves as a single point of processing for participants. CEEs operate virtually with staff from numerous trade positions considered to be experts in the established CEE industry. The assigned CEE will provide "one stop" processing for entry summaries and subsequent entry activities. For example, required import documents are routed to the responsible CEE where all validation activities, protests, post-entry amendment reviews and prior disclosure validations are conducted. Revenue collection, however, will continue to be carried out at the ports of entry or through existing automated payment methods. Imports entered through CEEs are processed in the same manner as regular imports.

Importers enrolled in the program are assigned to a single CEE, based upon their primary industry. When a participating importer imports goods that fall outside its typical import profile, their assigned CEE will collaborate with other CEEs and CBP personnel to resolve any cross-industry issues. The CEE program is an account-based program in line with CBP's broader focus on account management of large importers. The concept of a National Account Manager will now be expanded to a larger pool of focused expertise on a particular industry.



CEE program beneficiaries

Currently, enrollment priority is given to “trusted trader” importers enrolled in both the C-TPAT and Importer Self-Assessment (ISA) programs. CBP has already begun notifying selected participants via email that their ISA-approved importer of record numbers are being moved to their assigned CEE. These importers are also being asked to notify their service providers (e.g., customs brokers) of this change. CBP plans to issue a Federal Register Notice with additional details on the enrollment process, eligibility requirements and selection criteria.

CEE program benefits

The program is expected to reduce transaction costs for importers. It will also ensure greater consistency and predictability in dealings with CBP. Importers using multiple ports who participate in CEE will no longer be subject to differing port-specific procedures for post-entry adjustments or protests, for example. Importers enrolled in the program will receive the direct benefits of centralized processing, and the trade community at large will also benefit from the concentrated industry knowledge and expertise of the CEE personnel.

The CEEs will also minimize the burden on importers to educate CBP personnel on their particular products and will eliminate unnecessary follow-up. Importers can contact CEE personnel with questions, much like importers today contact National Import Specialists for focused advice on a particular product. In addition, CBP expects CEE personnel to develop training initiatives for other CBP personnel and the trade community at large.

Further, the CEE centers will increase overall port security by allowing ports of entry to focus CBP resources on high-risk shipments and importers. This increased focus will result in increased revenue protection, reduce economic loss due to intellectual property rights theft, and help increase overall port safety.

CEE planned expansion

With the expansion of the CEE program in May to four centers, US importers should be prepared to see additional centers announced soon. CBP has published plans to further expand the program in 2013 by adding five CEEs in the following industries: Agriculture & Prepared Products; Base Metals & Machinery; Consumer Products & Mass Merchandising; Industrial & Manufacturing Materials; and Textiles, Wearing Apparel & Footwear. CBP has yet to announce potential locations for these centers.

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US export control update: new ECCN 0Y521 explained



On 13 April 2012, the U.S. Department of Commerce, Bureau of Industry and Security (BIS), published a final rule amending the Export Administration Regulations (EAR) by creating a new Export Control Classification Number (ECCN) series, 0Y521. This series is intended to act as a holding ground for potentially sensitive items and technologies not yet recognized on the Commerce Control List (CCL) or United States Munitions List (USML).

While temporary, classification in the 0Y521 series creates a nearly worldwide license requirement, excepting only Canada, with a stated case-by-case license review policy through regional stability (RS Column 1) controls. In effect, this amendment makes it far simpler for BIS to quickly impose strict controls on unknown, emerging technologies and items.

ECCN 0Y521 determinations

Classification under the 0Y521 series will be determined by BIS, with the concurrence of the Departments of Defense and State, based on “whether the item has significant military or intelligence advantage to the United States or for foreign policy reasons.” However, this determination would not factor in an item’s “technical characteristics.” BIS assured a commenting party that the potentially subjective term “advantage,” while open to a certain degree of interpretation, was appropriate, and restated its intent to limit classification to those items truly warranting temporary classification.

BIS will also look to its Technical Advisory Committees for input from industries developing emerging technologies. This appears to be the only instance where industry will be able to contribute to the government’s decision-making process.

Exporters (and re-exporters) will have no notice that a sensitive technology is becoming controlled. Proposed rules will not be published so as to protect US national security interests. Rather, once the determination is made, new 0Y521 items will be published in the Federal Register as amendments to Supplement No. 5 to part 774 of the EAR.

The effects of 0Y521 are concentrated in Supplement No. 5 and do not result in changes to the CCL itself;

BIS determined this approach was preferable to adding individual ECCNs to the CCL.

ECCN 0Y521 classifications are excluded from the part 756 appeals process. However, parties can submit information or comments about newly controlled items.

Temporary period

Items may be classified under ECCN 0Y521 for one-year, followed by two possible yearlong extensions. BIS cites the three years as necessary and sufficient for the US government and its multilateral regime partners to assess proper classification of the item. The final rule, however, went so far as to add the possibility of extension beyond three years if the Under Secretary for Industry and Security determines an additional extension is in the national security or foreign policy interests of the US.

Closing thoughts

The US government previously defaulted to controlling critical new items and technologies under the International Traffic in Arms Regulations to prevent an automatic determination of EAR99. The 0Y521 ECCN series makes it markedly simpler for BIS to quickly control emerging items and technologies without the need to fully vet and justify an entirely new classification.

Business is hopeful that the new series will be useful as a mode for moving items from the USML with eventual classification as EAR99. Prior concerns over moving items from the USML directly to EAR99 classification, which would require congressional notification, would be assuaged with the temporary restraints instituted by 0Y521 classification. The industry at large desires transparency and simplicity in export control reform – it remains to be seen if the 0Y521 series is a step toward consolidation and future reform, or instead results in added complexity.

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Asia-Pacific free trade developments: an Australian perspective



Malaysia – Australia Free Trade Agreement signed

On 22 May 2012, Australian Trade Minister Craig Emerson signed a bilateral free trade agreement with Malaysia (the Malaysia-Australia Free Trade Agreement, or MAFTA). Currently, Australian and Malaysian manufactured goods have access to preferential treatment under the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA). However, with the MAFTA in place, Australian importers and exporters will have access to increased benefits that will be accessible under a simplified framework. Domestic ratification in both Australia and Malaysia is expected by 1 January 2013.

Benefits of the MAFTA include:

- ▶ The removal of tariffs into Malaysia on more than 97% of Australian made goods, which includes some of Australia's largest exports to Malaysia such as iron, steel, wine, small cars and a broad range of manufactured products.
- ▶ The acceleration of the removal of Australian tariffs on Malaysian manufactured goods, with many items receiving immediate tariff removal upon ratification. This is beneficial when compared to the gradual removal of tariffs on these same goods under the AANZFTA.
- ▶ Australian companies will be able to gain a company majority shareholding in a variety of Malaysian industries.
- ▶ Simplified access to preferential treatment and declarations of origin, rather than certificates of origin, will be utilized in support of preferential status.

We also provide below an update to the March 2012 issue of *TradeWatch* with respect to Australia's free trade agreement negotiations currently underway.

Trans-Pacific Partnership (TPP)

The Trans-Pacific Partnership (TPP) agreement negotiations, which involve Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam, are continuing to make progress with the latest round taking place in the US (Dallas, Texas) in May 2012. Despite many TPP representatives remaining quiet on what was discussed during negotiations, the U.S. Trade Representative (USTR) Ron Kirk states that better than expected progress has been made as a result of the 10 days of negotiations, with all parties making headway toward concluding the agreement.

Significantly, Canada, Japan and Mexico have each formally expressed interest in joining the TPP. Australia and other current members of the TPP have welcomed this news. These three countries will now be subject to the same entry process that each current member of the TPP undertook prior to joining and this will include a discussion surrounding their current readiness to join as well as their capacity to maintain both the ambition and pace of the negotiations. The USTR has stated the priority for existing members is to conclude the agreement before admitting new members. In addition, the outcome of negotiations between Australia and Japan to finalize the Australia – Japan Free Trade Agreement (FTA) may impact upon Australia's support of Japan joining the TPP. At this stage, the goal to complete the partnership by the end of 2012 has not changed and negotiations are scheduled to continue during July in San Diego in the United States.



Australia – People's Republic of China

In March 2012, the 18th round of negotiations was held in Canberra, Australia with both parties agreeing further progress has been made and some areas nearing finalization. Following the negotiations, Australian Trade Minister Craig Emerson revealed that he and China's Commerce Minister, Chen Deming, had agreed to review methods to conclude the agreement. Emerson flagged that a change in Australia's policy of ensuring all free trade agreements are comprehensive and complete prior to finalization may also be reviewed to enable the agreement to proceed. Talks between the countries began seven years ago and have faced a number of difficulties, especially in the area of agricultural trade. China remains Australia's number one export destination with around AU\$70 billion being exported there last financial year.

Australia – Japan

Negotiations continued for the 15th round in Canberra during April. The two countries remain apart on issues in the agricultural sector and this discord could prevent Japan from gaining Australia's support in TPP negotiations. Australia did report significant progress across a number of areas of the FTA and will move to finalize these at the next round of meetings in Tokyo in late June. A deal is unlikely to be complete until the parties can agree on the specifics of the agricultural sector surrounding beef, wheat and dairy products.

Australia – India

Australia and India held the third round of negotiations for the Australia-India Comprehensive Economic Agreement in Sydney in May. Progress was made during the talks but the agreement is not yet near completion. There has also been a significant push from Indian companies to reach an agreement, as they see Australia as a promising market and wish to strengthen trade relations between the two nations. Trade between the two countries has increased significantly from US\$3.3 billion in 2000, to US\$22.2 billion in 2010, with India becoming Australia's third largest export market.

Watch for more Australian free trade developments in future issues of *TradeWatch*.

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Australia

New amendments to Enhanced Project By-law Scheme



On 11 April 2012, the Australian government announced amendments to the Enhanced Project By-law Scheme (EPBS), which allows duty-free importation of equipment for certain capital projects. The amendments commence on 1 July 2012 and will create additional administrative and compliance burdens for EPBS project applicants. Consequently, importers may need to consider alternative duty reduction methods such as free trade agreements and tariff concession orders in managing customs duty costs.

The EPBS is a project-specific customs concession that allows an eligible project proponent (i.e., company project owner/operator) to enter eligible goods into Australia duty-free where it can show that it has provided full, fair and reasonable opportunity to the Australian industry to participate. This is done by the implementation of a detailed and robust Australian Industry Participation Plan (AIP Plan).

The recently announced EPBS amendments originate from the recommendations listed in the AIP Working Group's report on measures to extend Australian industry participation. The AIP Working Group was established to advise the Australian government on ways to enhance Australian industry participation.

The Australian government expects Australian suppliers to benefit from the amendments through increased opportunities for local suppliers to participate in major projects. To achieve this objective, greater transparency measures are placed on EPBS applicants. The key amendments are summarized below.

- ▶ Specific items needed for the project must be disclosed to the Department of Industry, Innovation, Science, Research and Tertiary Education (DIISRTE) and published.
- ▶ Project proponents will be required to provide an estimate of Australian versus international suppliers to be published by DIISRTE (where not commercial-in-confidence).
- ▶ An executive summary will be published by applicants via DIISRTE to summarize the applicant's AIP plans. The specific areas required to be covered by the executive summary include:
 - ▶ A description of the project admitted under the EPBS
 - ▶ How the project proponent will gather information on potential Australian industry opportunities and how these opportunities will be communicated to Australian suppliers
 - ▶ Details of opportunities expected to be available to Australian suppliers and actions the project proponent will implement to ensure national suppliers, of all levels and tiers, have opportunity to participate in all stages of the project
 - ▶ The process and criteria the project proponent will use to select suppliers
 - ▶ Initiatives the project proponent will undertake (i.e., government programs) to enhance the capability of Australian suppliers to participate in future projects



- ▶ Projects over AU\$2 billion have additional requirements, including:
 - ▶ Publishing prequalification requirements with tender information
 - ▶ Reporting to DIISRTE every six months regarding actions taken in their AIP plan, details of contracts awarded and why Australian bids were unsuccessful, information on Australian industry capability gaps and upcoming contracts

Further guidance on these amendments will be published mid-2012.

Overall, these changes place increased administrative hurdles on EPBS concession applicants. Consequently, project proponents should take time at the initial stages of a project to determine which concessional mechanisms are right for the project, especially where the project has a capital spend less than AU\$250 million. While the effective date for the amendments is 1 July 2012, any applications lodged after the announcement date (11 April 2012) are subject to the new rules. Accordingly, for project proponents that are currently undertaking an EPBS application, steps must be taken to ensure compliance with the new rules.

For additional information, contact Melissa McCosker, *Brisbane*, Ernst & Young (Australia) at melissa.mccosker@au.ey.com (Tel. +61 7 3011 3148).



Tariff classification developments

Two recent Australian cases demonstrate the uncertainties of tariff classification and the need to take steps to strengthen your classification position. These cases also continue the trend of Australian courts and tribunals to take into account a wide variety of factors when classifying goods for both general classification purposes and in considering the application of classification-based duty-free concessions.

Aldi Stores and CEO of Customs

In *Aldi Stores and CEO of Customs*, the Administrative Appeals Tribunal had to consider whether a standard nappy (diaper) fit within the definition of a tariff concession order (TCO) that applied to “pants, disposable” (with additional technical requirements). The TCO was intended to cover disposable pants (pull-ups) used by small children to assist with toilet training.

A TCO is a classification-based concession that is granted to an applicant proving that substitutable goods are not manufactured in Australia. Once made, a TCO can be used by any importer whose goods fit within the terms of the order.

The main argument in *Aldi Stores* was whether the imported product was a “nappy” or a “pant.” In determining this issue, the Tribunal considered that the characteristics of the goods, their get-up, color, decoration, labeling and packaging were all important.

In finding that the goods were nappies, and not pants, the Tribunal referred to the design of the goods and also noted that the goods were described as nappies on the packaging of the importer. (Customs also noted that the product was described as nappies in the commercial invoices and shipping documents of the applicant.)

Additionally, the Tribunal referred to the original application for the TCO, which contained a stated purpose of the goods. That purpose is nominated by the original applicant for the TCO and does not form part of the TCO.

The case demonstrates the importance of ensuring that goods are described in commercial documents in terms that are firstly accurate, and secondly, consistent with the importer’s desired classification of the goods. An imprecise description of goods in commercial documents may later be used by Customs against an importer.

The case also illustrates the importance of the intended use of goods described in applications for TCOs when later interpreting the terms of those TCOs. This stated use will be referred to where necessary to clarify the terms of the TCO. We recommend that if the use of the particular TCO is not clear, importers obtain and review the published intended use of the goods covered by the TCO.

Linen House Pty Ltd and CEO of Customs

A wide approach to the classification of goods was also shown by the Tribunal in *Linen House Pty Ltd and CEO of Customs*. In this case, the Tribunal had to consider whether European pillow cases and other covers for decorative items should be classified as bed linen or other furnishing articles. The importer argued that European pillows are decorative items and their covers are not bed linen, as opposed to pillow covers for “standard” pillows. In previous cases, the Tribunal had held that covers for items that decorate a bed were not bed linen; bed linen was a cover for items used for sleeping on or under.



The Tribunal was prepared to take a different approach in this case and held that the usage of the term “bed linen” had changed over time and now included covers for decorative cushions even if those cushions are likely to be removed before the bed is slept on.

This case demonstrates that the classification of a product can change over time due to changes in how society views and uses a particular product. The case acts as a warning that classification is not static and that if the usage, or how that product is viewed by society, changes, the classification of the good may also change. In Australia, this risk can be managed by seeking a binding tariff advice from Customs. While a tariff advice can be revoked by Customs due to a change of position, Customs would not be entitled to retrospectively change the classification of past imports and collect any underpaid duty.

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China

China Customs issues advanced customs valuation rules



China's General Administration of Customs (Customs) has implemented a new advanced ruling process specifically for customs valuation. The Provisional Rules of Advanced Customs Valuation (ACV), released in the official document ShuShuiFa [2011] 419, took effect from 1 January 2012. The rules are devised to improve clearance efficiency and the valuation process for goods imported into the People's Republic of China.

Pursuant to the ACV, the applicant for a ruling must be a Grade A or AA corporation (i.e., corporation with high standards of trade compliance under China's customs enterprise classification system). The ACV procedure requires a written application that must be submitted at least 15 working days in advance of the import declaration of the goods specified in the application. In addition, the application must be submitted with the following documents:

- ▶ Corresponding contract for the application
- ▶ Contract, invoices and other relative documentation
- ▶ Letters, communications and other documents reflective of transactions or price quotations
- ▶ Other documents requested by Customs

If it is determined that the proposed dutiable price for the goods in the application complies with the relevant customs valuation rules, then the appropriate authorities shall issue an ACV ruling confirming the acceptance by Customs. The ACV ruling shall apply only to the goods (and circumstances) specified in the application. It shall be valid for 90 days, although a 30-day extension may be obtained with Customs' approval.

With respect to the scope, the rules delegate to Customs at the provincial level the ability to specify the goods that qualify for an ACV ruling in accordance with its local policies. However, the scope of goods shall mainly fall within the following categories:

- ▶ Goods where there is great fluctuation in the market and it is difficult for the clearance department and documentation verification department to obtain pricing information in a timely manner
- ▶ Goods where there is insufficient information on imported goods valuations and the clearance department and documentation verification department have demanded pricing enquiries multiple times
- ▶ Goods where there are difficulties in the imported goods valuation process and the clearance department and documentation verification department have applied for professional valuation rulings multiple times
- ▶ Goods with other difficulties during the customs valuation process

The new ACV rules are the culmination of the previous pilot program in Shanghai. During the pilot, it was observed that Customs, in practice, would normally be reluctant to apply the program in a broad manner, opting instead for a limited application. This is reflected in the rules, as the scope is limited in nature, and no specific list of eligible goods has been provided to date. Therefore, without additional guidance, there is still an air of uncertainty surrounding the ACV application.

Customs valuation is always a challenging area for multinationals that have import operations in China, especially for those with significant trade volume between related parties. While the introduction of the new ACV rules creates a new avenue to provide additional certainty, in the short-term the benefits are yet to be observed.

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India

India trade developments affecting duty concessions and exemptions



We provide below a high-level look at some recent trade developments in India that affect duty concessions and exemptions for a wide range of products.

India withdraws duty concessions on certain imported inputs

On 17 March 2012, the Indian Finance Ministry announced Notification No. 16/2012, which

provides for the immediate withdrawal of customs duty concessions for certain inputs imported for the manufacture of excisable goods, subject to conditions. The duty concessions had been granted under Notification Nos. 25/1999 and related amendments.

The affected products subject to the duty concession withdrawal include the following inputs imported for manufacture in certain finished products, as indicated.

No.	Harmonized System chapter, heading, sub-heading or tariff item	Description of imported goods	Description of finished goods
1	71 7220 1290 7409 11 00 7409 90 00	<ul style="list-style-type: none"> ▶ Silver bronze strips/coils copper strips/coils/ sheets copper nickel alloy or other alloys of copper in strip/coil/sheets ▶ Stainless steel strips 	<ul style="list-style-type: none"> ▶ Relays ▶ Switches
2	74	<ul style="list-style-type: none"> ▶ Phosphor bronze sheets/ bars/section/flats/ strips/wire/ rod/foils/pipes, with or without plating 	<ul style="list-style-type: none"> ▶ Relays/parts of relays ▶ Tape deck mechanism ▶ Connectors/parts of connectors ▶ Potentiometers/parts of potentiometers ▶ Heat sinks ▶ Cassettes, parts of cassettes ▶ Television tuner ▶ Telescopic antenna ▶ Gas discharge tubes/parts of gas discharge tubes ▶ Switches, parts of switches
3	74, 85	<ul style="list-style-type: none"> ▶ Oxygen-free high conductivity copper wires, bars, rods, angles, shapes and sections, plates, sheets, strips, tubes and pipes 	<ul style="list-style-type: none"> ▶ Semi-conductor devices ▶ Electronic valves and tubes ▶ Transistor headers ▶ Glass to metal seals ▶ Capacitors
4	74	<ul style="list-style-type: none"> ▶ Cladded copper/copper alloy strip/foil 	<ul style="list-style-type: none"> ▶ Switches with contact rating less than 5 amperes at voltage not exceeding 250 Volts AC or DC ▶ Connectors, DC micro-motors, parts of connectors
5	74	<ul style="list-style-type: none"> ▶ Unplated brass strips in coil form 70mm width ▶ Phosphor bronze strips in coil form 	<ul style="list-style-type: none"> ▶ Connectors
6	72, 74	<ul style="list-style-type: none"> ▶ Bimetal sheets in coil forms/piece parts ▶ Copper clad steel sheets in coil forms/piece parts 	<ul style="list-style-type: none"> ▶ Relays of contact rating up to 7 amperes

The affected inputs are now subject to most-favored nation duty rates upon importation.



India amends conditions to avail special additional duty exemptions to certain imports

On 8 May 2012, the Indian Finance Ministry amended the conditions for availing exemption of special additional duty (SAD) on certain imports pursuant to Notification No. 32/2012-Customs.

The amendment affects all pre-packaged goods intended for retail sale with the sales price marked on the package. Additional products subject to the notification include the following goods as classified under the Harmonized Schedule:

- ▶ Chapter 30 – Patent and proprietary medicines
- ▶ Chapter 61 (excluding 6117 90 00)
- ▶ Chapter 62 (excluding 6217 90)
- ▶ Sub-heading 8517 12
- ▶ Heading 9101
- ▶ Heading 9102

Effective 1 June 2012, the specified goods are subject to a different set of conditions. Specifically, the importer declaration must indicate:

- ▶ State of destination where the goods are intended to be taken immediately after importation, whether for sale or for distribution on a stock transfer basis.
- ▶ Value-added tax (VAT) registration number, sales tax registration number or central sales tax registration number in that same state (i.e., where the goods are intended to be taken immediately after importation).

Previously, the declaration requirements for SAD exemption on the above goods focused on the state where the goods were intended to be sold for the first time after importation with VAT paid. The change in conditions is in response to situations where, at the time of import, the importer does not know the state where the imported goods would finally be sold. In this case, the goods would commonly be transferred to the importer's warehouse for the interim period before the final sale. However, it was unclear whether the importer could use the state where such warehouses were located for purposes of the declaration to meet the SAD exemption condition.

This modification thus resolves the issue, as now the importer can clearly use the state where the goods were taken immediately after importation (e.g., the warehouse), whether for sale or for distribution on a stock transfer basis. We emphasize that this change only affects the products indicated in the notification. Declarations for other products must abide by different conditions for SAD exemptions.

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New Zealand

New penalty regime for importers



Importers need to be aware of significant increases to penalties that the New Zealand Customs Service (Customs) will now be able to impose for errors in relation to import entries. These changes are a result of the Customs & Excise Amendment Bill, which received Royal assent on 5 April 2012.

Increased penalties apply to a broader range of imported goods

The changes to New Zealand's customs penalty regime are summarized as follows:

Category of goods	Previous maximum penalty	Current maximum penalty*
Subject only to GST on importation	Maximum of NZ\$50 per entry	Maximum of 20%, 40% or 100% of the shortfall per entry (depending on the degree of culpability)
Subject to duty and GST on importation	Maximum of NZ\$10,000 per entry	Maximum of 20%, 40% or 100% of the shortfall per entry (depending on the degree of culpability)

**The new penalties that have been introduced will be capped at NZ\$50,000 per import entry.*

There is no longer any penalty relief for importers when the goods are only subject to Goods and Services Tax (GST), even though the importers are registered for GST and are able to recover the GST from the Inland Revenue. The fact there will be no loss of revenue to the government is unlikely to sway Customs regarding their decision to impose penalties.

Lack of customs notice requirements

The strengthening of the penalty regime strives to be a heightened incentive for importers to improve voluntary compliance with respect to the accuracy of customs declarations. The new regime has been modeled on the Inland Revenue approach under the Tax Administration Act. However, some of the beneficial notice requirements taxpayers enjoy under the Tax Administration Act have not transferred to the Customs & Excise Act.

For instance, a controversial aspect of the change is that it takes away the opportunity for importers to present their case prior to the imposition of penalties. This is due to the removal of the pre-penalty notice that is currently required to be issued by Customs. Instead, there is now a 20-working-day time frame to appeal to the Customs Appeal Authority or request a review by Customs. This has been referred to by the Legislation Advisory Committee in its 2010 Annual Report as "pay now, argue later" and fundamentally incompatible with the principles of natural justice. The Committee's stance is understandable considering that, in practice, an importer facing a high penalty assessment may be subject to costly cash flow implications even though the importer may have a winning case against the assessment.

Another concerning aspect is that unlike the rules for Inland Revenue, there is no requirement for Customs to provide notification of audit in writing. It is common for Customs to work its way through an organization during the course of an audit without the importer knowing they are actually subject to a customs audit. As a result, the importer may unknowingly miss the opportunity to submit a voluntary disclosure, which has become a more important avenue for penalty mitigation considering the costly aspects of the new regime.



Increased focus on target compliance areas

We anticipate that Customs will target certain importers to derive additional revenue through this new penalty regime. The target compliance areas include the following:

- ▶ Imports from related parties
- ▶ Transfer pricing adjustments
- ▶ Consignment stock arrangements
- ▶ Movements of stock (e.g., from an overseas head office to a New Zealand branch)
- ▶ Royalties and other adjustments to the price required to be made to determine the transaction value of the goods
- ▶ Systematic errors embedded within systems and processes (e.g., classification errors, origin errors and incorrect treatment of insurance costs)

Increased importance on a proactive approach to customs compliance

Given Customs' strengthened approach to penalties, non-compliance can prove costly. Importers cannot afford to wait until Customs identifies an error. Accordingly, it has become increasingly important that importers adopt a proactive approach to customs compliance. By proactively addressing customs compliance, companies are in a better position to identify customs risk areas and address them. Proactive steps include:

- ▶ Being prepared for customs inquiries with documentation to support customs positions
- ▶ Obtaining rulings from Customs to provide greater certainty
- ▶ Improving compliance through effective processes and internal controls
- ▶ Conducting periodic reviews to assess the accuracy of import declarations
- ▶ Consider submitting a voluntary disclosure to mitigate any penalty exposure

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Europe, Middle East and Africa

European Union

Tariff classification challenges and opportunities for the technology sector: an EU perspective



For many business sectors, customs duty rates are a significant factor for cost calculations of globally traded goods. This is particularly true for the technology sector with highly competitive markets and low trade margins for products that can be subject to a high range of customs duty rates (e.g., from zero up to 14% in the EU). Information and communication technology (ICT) goods have generally enjoyed duty-free access since the 1996 implementation of the World Trade Organization Information Technology Agreement (ITA). The ITA now has more than 70 contracting member countries, which represent about 97% of worldwide trade in this sector. However, despite the ITA, new and emerging technological innovations are creating tariff classification challenges with customs duty implications.

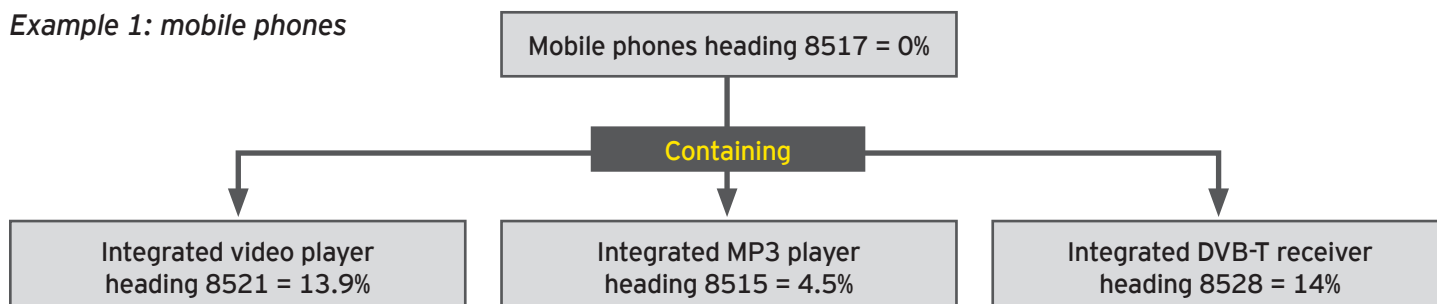
From a tariff classification standpoint, the ITA draws the line between ICT goods and consumer electronic goods. ICT goods covered by the agreement enjoy duty-free status, while consumer electronic goods can attract high customs duty rates. So a key consideration for classification of goods belonging to this sector is whether the good or group of goods can qualify under the Harmonized System (HS) tariff headings covered by the ITA.

The problem today concerning the ITA is that the covered goods are based on technology that existed more than 15 years ago, i.e., when the ITA was implemented. Since then, considerable new technological innovations have entered the market that might not fit clearly within an existing HS description covered by the ITA, thus making the agreement outdated in many respects.

Further, the increasing minimization of electronic components has led to an integration of functions within one technical device. In a system in which classification is based on functions, technological innovations can make it difficult to determine the so-called principal function. As a consequence, these new functions can lead to re-classification and higher customs duty rates.

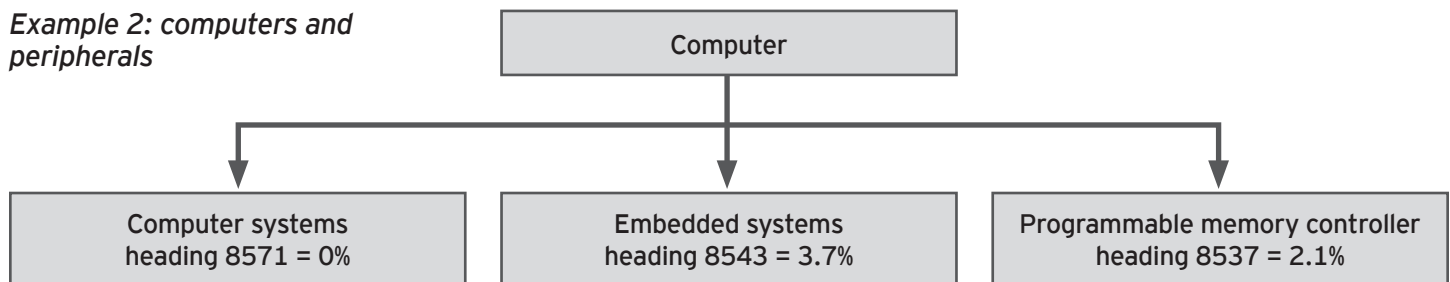
Based on our experience, we highlight some groups of goods that should be subject to examination regarding their classification under the HS:

Example 1: mobile phones

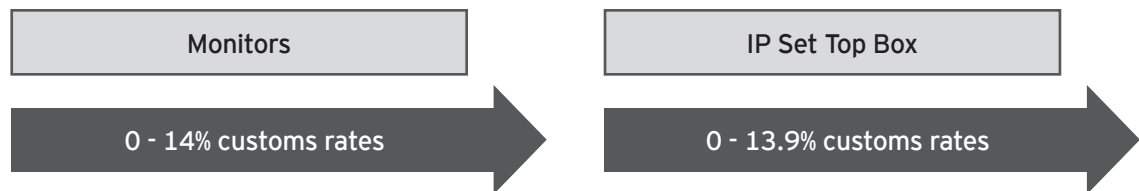


Especially the technological development of mobile phones is a good example to show the incredible speed of integration and the results of this development from the tariff perspective. Even though this problem was resolved in 2009 – through a classification order by the Commission of the EU – it shows the effects on classification results caused by integrating functions in one device.

Example 2: computers and peripherals



Based on the common understanding of the word “computer,” this example shows that there are different headings within the tariff where so-called computers can be classified. Due to technical developments, the line between these headings is blurring and in some cases only the applied software makes the difference.



The same problem applies to the classification of IP Set Top boxes and monitors, only to name some more examples.

Also, newly developed goods like so-called tablet-PCs that have an ever-growing range of functions can cause classification problems. It is definitely a good idea to think about classification before launching new products to make sure that the cost calculation is right. The above examples demonstrate how the addition of functions to a product can change the tariff classification and duty result. Accordingly, such considerations are imperative to draw the line between different HS code numbers to properly classify the product.

Implications for business

The implications for incorrect classifications can be significant. Customs authorities in the EU can audit the company and review the classification of goods up to three years retrospectively. In case of misclassification, this can lead to the post-clearance collection of underpaid duty and related taxes as well as penalties. Given the extreme customs duty differential that can occur (i.e., from zero up to 14%), the liability for underpaid duty can be a significant exposure and can even cause insolvency in extreme cases. Yet, many companies are still not aware of this high financial risk.

On the other hand, many importers may be paying higher customs duty than legally owed. In other words, companies that are not actively reviewing their tariff classification with an understanding of the HS rules may be overlooking opportunities to classify the good under a duty-free or lower duty HS heading. In addition to the duty savings, duty-free classifications can lead to a possible abdication of customs processes with economic impact thereby expediting customs clearance and getting the goods on the market quicker.



There is currently growing momentum for the WTO to initiate negotiations to expand the ITA to cover additional ICT goods. This will be an important development for the technology sector to follow and potentially, an area where industry input can be effective.

As with the technology sector, for any business sector faced with high competition and low trade margins, a duty-free or lower duty classification rate can be a strong competitive advantage. This is particularly important for goods where minor technical distinctions are imperative for classification determinations among HS codes with a high range of customs duty variances. Actively managing tariff classification in the jurisdictions where your company does business can provide an often overlooked opportunity to reduce costs and manage risks associated with cross-border trade.

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Hungary

Significant changes to Hungary's green tax system



Effective 1 January 2012, Hungary has implemented significant changes to its environmental taxation system pursuant to Act LXXXV of 2011. The new law alters many aspects of the environmental product fee (green tax), particularly for packaging products. Companies are scrambling to understand the implications for their business and the extent of their compliance responsibilities.

Background

Environmental levies are a common feature of modern-day indirect taxation systems. Since 1995, Hungary has applied a green tax on certain products assumed to create waste in bulk. Such products include plastic bags, cans and various other forms of packaging as well as small-sized electric and electronic appliances, batteries (accumulators), mineral oils, advertising papers and the packaging materials. The determination as to the taxable entity (e.g., user, buyer, distributor or manufacturer) depends on the product at issue.

Entities subject to the tax are required to register with the authorities and make quarterly declarations (i.e., tax returns). The tax assessment is based on the product's tariff classification code and other criteria, such as weight.

In 2008, the customs authorities took over the administration of the green tax (which also forms part of the value-added tax base). Since then, businesses have placed heightened attention on compliance considering the rigorous enforcement attitude of the customs authorities. For example, the customs authorities were able to expand the registry of taxable entities through a disclosure program that granted a grace period to companies that had neglected their obligations to comply and allowed them to pay their delinquent green tax liabilities with significantly reduced sanctions.

Due to the peculiar nature of the green tax, compliance is challenging. Proper reporting requires close cooperation between various divisions of the enterprise (e.g., finance, logistics, customs and quality management) to ensure that accurate information is reported on the declaration. The tax can also require the involvement of various parties involved in the supply chain when information or statements from business partners is required, thus adding to the administrative burden.

Recognizing the administrative burden as well as leakages in the legislation and the partial inefficiency of the waste recycling and collection process, the Parliament passed the completely new green tax act in 2011. Implementing provisions that provided some interpretation of the act's clauses and more detailed rules for compliance were only published in December 2011, leaving affected businesses with little time to adapt to the new system.

While there are some beneficial aspects of the new law (e.g., administrative simplifications), some of the more significant changes lack clarity in their practical application. Many of these issues have surfaced as businesses filed the first quarterly declaration under the new system.

Focus on packaging materials

Perhaps the most fundamental changes introduced affect packaging materials. Previously, only entities physically packing their goods using packaging materials were uniformly subject to the green tax. In other words, the tax focused on the users of the packaging.

Under the new rules, entities producing and selling packaging materials are now subject to the green tax, provided that their customers use the purchased materials to package goods for onward sale. Different rules apply depending on whether the packaging materials are imported or purchased locally. The new rules have been confusing in practice, leaving business entities puzzled as to whether or not they are liable to the tax at all.



Severely limited tax exemptions

Additionally, the law abolished many of the allowable exemptions from the green tax. For example, an up-front exemption no longer applies for companies that have established arrangements with recycling coordinators. Rather, only reduced charges will be available to entities that conduct their own waste collection.

Further, reusable packaging materials (e.g., pallets) are only exempted where a deposit/refund system is utilized with sufficient tracking. More guidance with respect to a feasible tracking system would be beneficial. Additionally, the law remains unclear on how the law applies to rentals of reusable packaging materials.

The law does provide a statutory exemption for sales of taxable goods abroad. However, due to the strict wording of the new law, additional scenarios, such as the lease of the same goods abroad, do not qualify for the exemption despite the fact that the waste is removed from the country.

Overall, the business community would welcome clarification as to the specific cases of exemption where the fundamental business activity does not trigger green tax at all.

Additional considerations

Some additional areas where the new law lacks clarity include:

- ▶ Ways to pass on the green tax liability to other parties of the supply chain (e.g., in the event of subsequent sales of the taxable goods for export or to other EU member states, thus physically removing the waste from the territory of Hungary)
- ▶ Formal requirements, such as invoicing clauses affecting ERP systems and invoicing software as well as exemption and refund clauses

While business hopes to have further guidance on these and other issues, more legislative changes are envisaged for the autumn, adding further challenges to the newly established system.

In our experience, individual requests for interpretation and clarification (e.g., guidance requests) have been well-received by the customs authorities. Although such guidance is not considered legally binding, the approach does support due diligence on behalf of the taxpayer, which can be advantageous in the event of a customs field audit. After all, these requests for individual guidance highlight to the customs authorities the practical issues businesses are experiencing as they try to comply with the new rules. This type of feedback can be beneficial as the customs authorities prepare guidance and further interpretation of the new law.

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Russia

Russia activates AEO program



Russia's AEO program was activated in the beginning of 2012 with the opening of the AEO Register and approval of various procedures related to the program.

AEO-approved companies gain special customs simplifications that facilitate and expedite the customs clearance process. In Russia, an AEO benefits from the temporary storage of goods at its warehouse. Additionally, AEOs enjoy certain customs operations that allow the release of goods directly at the warehouses of an AEO before submitting a customs entry by using a special procedure to complete the customs transit. Such simplifications do not apply to certain categories of goods, and limitations are imposed on excisable goods to be labeled.

According to the Russian customs legislation, an AEO may be a legal entity registered in accordance with Russian law that imports goods into Russia for use in production and other entrepreneurial activity and/or exports goods from Russia. The entity must be entered in the AEO register and meet the following requirements:

- ▶ Engagement in foreign trade activity for at least one year
- ▶ Absence of outstanding obligations to pay customs duties and taxes
- ▶ Absence of liability for two or more customs offences involving imposed fines totaling RUB500,000 or more within one year
- ▶ Use of a certain system for recording goods and logistics operations

Additionally, the AEO must present collateral for the payment of customs duties and taxes in an amount of no less than €1 million; however, for companies producing and/or exporting duty-free goods, this amount is €150,000.

The AEO Register is maintained by the Federal Customs Service (FCS) of Russia and no payment is required for examining an application and entering an operator in the Register. An operator is entered in the AEO Register on the basis of an approved application once compliance with the program requirements is confirmed.

As of April 2012, more than 60 applications were submitted to the FCS with three legal entities approved thus far.

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Turkey

New incentive system in Turkey



In April 2012, the Prime Minister announced Turkey's new incentive system, which aims to increase investment for certain industry sectors and for underdeveloped regions. The primary incentives include certain customs duty and VAT exemptions and, in some cases, VAT rebates that together with other tax and fiscal incentives place the spotlight on Turkey as an attractive export manufacturing location for new investment projects.

The Ministry of Finance recently provided additional detailed explanations regarding the new incentive system. Basically, Turkey's provinces have been divided into six regions in terms of socio-economic development with the most incentives available to the most underdeveloped areas. The incentive system is comprised of four main components:

- 1) **General incentive applications** – apply generally to investments that meet certain minimum fixed levels.
- 2) **Regional incentive applications** – apply to investments that meet certain minimum fixed levels based on region.
- 3) **Incentivization of large-scale investments** – designed to support certain industry sectors (e.g., petroleum, auto, pharmaceutical and electronics, among others) and apply to investments that meet higher fixed levels than general incentive applications or regional incentive applications.
- 4) **Incentivization of strategic investments** – designed to support the development of strategic sectors, which are dependent on the importation of intermediate goods, intense research and development, advanced technology and/or high added value, and apply to investments that meet certain minimum fixed investment levels, importation levels and value-added levels.

In the framework of these applications, investors will be provided with the following benefits:

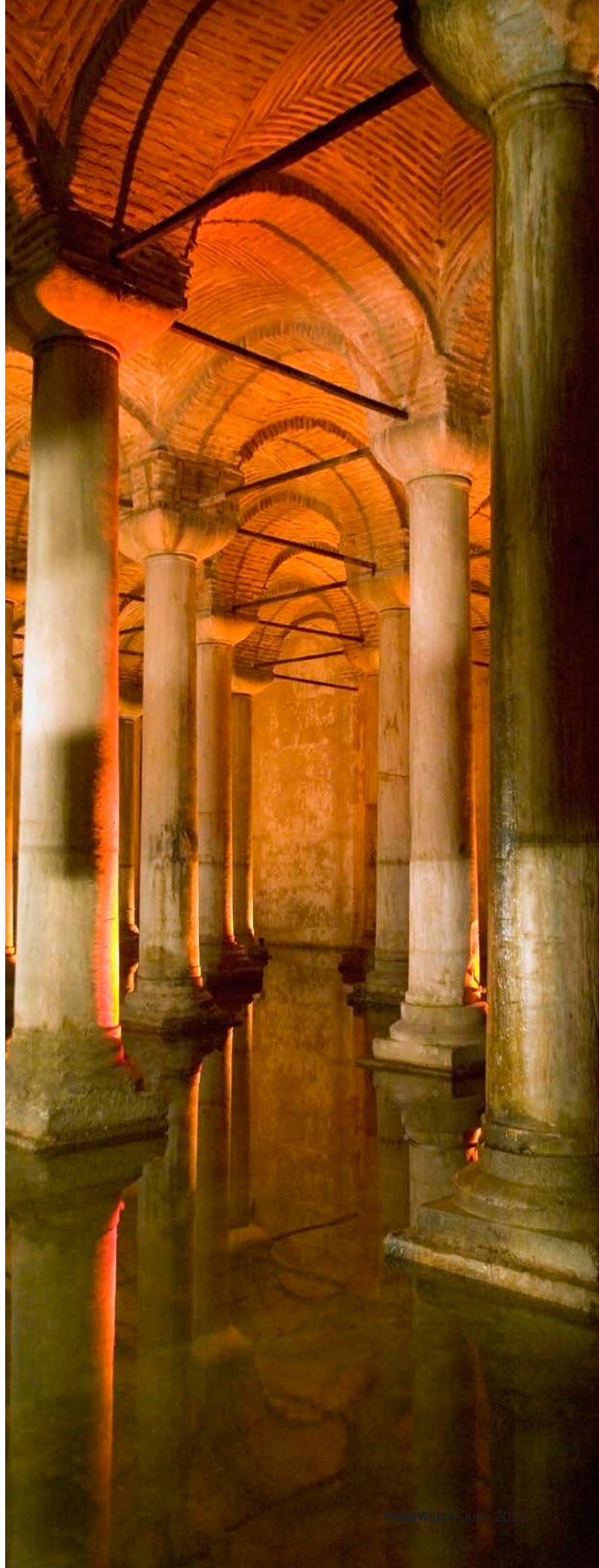
New incentive system ²			
<i>General incentive applications</i>	<i>Regional incentive applications</i>	<i>Incentivization of large-scale investments</i>	<i>Incentivization of strategic investments</i>
<ul style="list-style-type: none"> ▶ VAT exemption ▶ Customs tax relief 	<ul style="list-style-type: none"> ▶ VAT exemption ▶ Customs tax relief ▶ Tax reduction ▶ Insurance premium employer's share ▶ Investment location allocation ▶ Interest support 	<ul style="list-style-type: none"> ▶ VAT exemption ▶ Customs tax relief ▶ Tax reduction ▶ Insurance premium employer's share ▶ Investment location allocation 	<ul style="list-style-type: none"> ▶ VAT exemption ▶ Customs tax relief ▶ Tax reduction ▶ Insurance premium employer's share ▶ Investment location allocation ▶ Interest support ▶ VAT refund³

²Additional incentives for investments in the 6th region (i.e., most underdeveloped areas) include income withholding tax support and insurance premium employee's share support.

³VAT refund support has been introduced for strategic investments related to building/construction expenditures that meet minimum investment levels of TRY500 million.

Overall, Turkey's new incentive system provides for indirect tax, direct tax and fiscal benefits that can be significant depending on the level of investment, industry sector and region applicable to the new investment. It is expected that, as before, the investment incentive applications will be implemented and followed up in the scope of incentive certificates to be granted by the Ministry of Finance. A Council of Ministers decision and related communiqués are expected to be published with respect to the issue. Therefore, the information above still requires a legal regulation.

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Ukraine

New version of the Customs Code of Ukraine takes effect



The new version of the Customs Code of Ukraine (the Code) took effect on 1 June 2012. The new Code aims to harmonize national legislation with international law and Ukraine's international obligations as a party to the Istanbul and Kyoto Conventions. In addition, the new Code will harmonize and develop a range of customs formalities.

The Code is a quite substantial document that makes numerous changes to current customs procedures and related regulations. We would like to concentrate your attention on the most notable rules, which we discuss below.

AEO

The Code introduces a new status for the AEO, one that may be granted to certain companies subject to their compliance with the following requirements:

- ▶ Performance of foreign economic activity for not less than three years prior to application to the customs authorities for AEO status
- ▶ Absence of underpaid customs duties and penalties as of the day of the application
- ▶ Absence of tax debts as of the date of the application
- ▶ The company's officials were not held liable for certain violations of the customs rules within three years prior to the application
- ▶ Availability of a goods accounting system that allows for comparing the documents and information submitted to the customs authorities with the documents and information that record the company's business activity
- ▶ Absence as of the date of application of unsettled liability accrued as a result of the document audit

AEO status may be granted only after the local customs office verifies and evaluates self-testing results and approves the submitted information and documents. The regulations require the AEO applicant to disclose a significant amount of internal (including confidential) information on the company's activity and structure during the self-testing process. It remains to be seen how local customs practices may impact the process.

The Code provides for a number of advantages for companies that have AEO status, including:

- ▶ A simplified (shortened) list of the information to be submitted to the customs authorities in relation to goods and commercial vehicles prior to their arrival in the customs territory of Ukraine and/or their departure from the customs territory of Ukraine
- ▶ Temporary storage of goods and commercial vehicles that are under customs control at the premises and in the outdoor/enclosed areas of the AEO
- ▶ Withdrawal of the customs security (guarantee) without the need to obtain a special permit from the customs authorities
- ▶ Shipment of goods from the premises and outdoor/enclosed areas of the AEO without having to present them to the departure customs authority
- ▶ Priority during customs control
- ▶ Placing of goods in a temporary warehouse without the need to obtain a permit from the customs authorities
- ▶ Exemption from providing a guarantee for internal customs transit of goods (save for excisable goods)
- ▶ Customs clearance of goods at the AEO's premises
- ▶ Submission of one customs cargo declaration for goods that are imported/exported into/from the customs territory of Ukraine more than once by one person under one foreign economic agreement within the period of time approved by the customs authorities



Customs value of goods and methods of determining it

The Code provides a specified list of documents for the declarant to submit to the customs authorities to support the customs value of goods. Additional documents (as listed in the Code) can be requested by the customs authorities only in the following cases:

- ▶ The submitted documents contradict each other
- ▶ The submitted documents show signs of fraud
- ▶ The documents do not contain all the information required for determining the customs value according to the method the declarant has chosen

The Code gives an AEO the right to automatically apply the transaction value method for determining the customs value of imported goods (for related and unrelated sales). In other words, for customs clearance purposes, the customs authorities must accept the transaction value declared by an AEO. We note that the AEO needs to be prepared to support the declared transaction value in the event of a post-importation audit.

With respect to other related-party sales, the Code provides that only when the customs authorities have reasonable grounds to believe that the existing relationship between the seller and the purchaser has influenced the declared customs value must the declarant submit the following additional documents, if available:

- ▶ An extract from the purchaser's accounting and bank documents on the sale of the evaluated goods or of identical or similar goods in the territory of Ukraine
- ▶ Information on the value of the identical and/or similar goods in the country of export
- ▶ Calculation of the price.

The Code also provides for cases when the customs authorities may reject the declared customs value, such as:

- ▶ The calculation of customs value is incorrect.
- ▶ The declarant did not submit the main documents that confirm the customs value.
- ▶ The declarant used an incorrect method for determining the customs value.
- ▶ The customs authorities obtained official information from the foreign customs authorities that the declared customs value is false.

Notably, if the customs authorities cannot substantiate that the declarant provided deficient and/or unreliable information on the customs value of goods, the customs value the declarant determined has to be accepted automatically. We note that we expect further guidance and clarity with respect to this provision.

Some special rules have been developed for determining customs value of carrier media bearing software and treatment of interest charges. Consistent with the option provided by GATT Decision 4.1, the customs value of carrier media bearing software should be based on the value of the carrier media itself. The value of the software should not be taken into account, provided that it is distinguished from the value of the carrier medium. Interest charges for financial arrangements (e.g., financial lease) should not be added to the customs value of imported goods, provided that the interest charges are distinguished from the price paid or payable and that other certain conditions are met.



Declaring goods and customs formalities

The changes with respect to the time and place of the customs clearance of goods appear promising. The Code has abolished the requirement that customs clearance of goods occur at the customs house at which the importer is registered. Hence, starting from 1 June 2012 importers are free to clear goods that are crossing the Ukrainian border at any customs house they consider appropriate. The state authorities are entitled to restrict the place of customs clearance only for excisable goods (i.e., alcohol and tobacco, passenger cars and car bodies, and certain oil products), natural gas, pharmaceuticals and goods subject to hallmarking (i.e., marking controls related to precious metals, jewelry, gems, etc.)

Under the new Code, customs clearance of goods must not take longer than four hours from the presentation of goods and submission of the documents to the customs authorities. This rule, however, does not cover the time required to conduct procedures in certain extraordinary cases, such as laboratory analysis in complex classification cases.

Contrary to the current regulations, the Code allows for quantity adjustments to the customs cargo declaration both prior to completion of customs clearance procedures and within three years following the completion of these procedures. If, after the release of goods for free circulation (provided the customs control in relation to these goods did not include a customs inspection), the declarant identifies goods that were not declared in the customs cargo declaration, the declarant may, subject to permission from the customs authorities, adjust the customs cargo declaration and increase the number of goods.

The Code also covers instances where the information necessary to accurately make the value declaration is not known at the time of importation. For instance, for royalties, license payments, and other elements of value that are defined depending on post-importation events, such as the volume of sales or proceeds from sales, the declarant may submit an additional customs cargo declaration within 180 days from the date of the goods' release.

Moreover, one additional customs cargo declaration that relates to several preliminary customs cargo declarations can be submitted provided that the preliminary declarations were formalized by the same customs authority, under the same foreign economic agreement and under the same customs regime, and that the period for submitting the additional customs cargo declaration is complied with. This mechanism is useful, in particular, for royalty and license payments that cover multiple customs cargo declarations.

Post-clearance control of goods; customs audit

The Code reflects the increasing role of post-importation enforcement. The Code substantially broadens the customs authorities' rights during audits. In addition, certain specific functions, such as initiation of inventory taking or suspension of the outcome transfer of funds (through court), have been delegated to customs auditors.

The Code provides for documentary field audits (at the premises of the audited company) and desk documentary audits (at the customs authorities' office). Documentary field audits can be scheduled or surprise visits. The Code also allows the customs authorities' officials to conduct counter reconciliations, which is a cross-check of the audited party's information from a counter party (i.e., business partner). This form of customs control is not an audit from a legal standpoint.

Importantly, the Code limits the terms of the audits that customs officials can conduct. A documentary scheduled field audit of a company cannot be held more often than once in 12 months. Such an audit of a company with AEO status cannot be held more than once in 30 months. A documentary field audit should not exceed 30 business days. This term, however, can be extended for not more than 15 days. Additionally, the audit can be suspended for up to 30 business days, subject to certain exceptions.



Fines and penalties

Following up on the legal changes introduced at the end of the 2011, the Code abolishes criminal responsibility for smuggling of goods, except for items of cultural value, poison and explosive substances, strong remedies, radioactive materials, weapons, ammunition and special devices for the informal collection of information. Now, the transportation of commodities beyond customs control or submission of unauthentic/unreliable documents for customs clearance purposes is subject to an administrative fine of 100% for the first offense and 200% if repeated assessed on the commodities' value, along with their mandatory confiscation.

The Code substantially changes the penalties for underpaying customs duties and taxes and other actions aimed at the avoidance or illegal reduction of import duties and taxes payable. According to the new Customs Code, these actions are subject to a fine of 300% of the underpaid taxes.

The Code is lenient when it comes to insignificant and non-intentional errors committed upon the declaration and customs clearance of goods. Declarants could be exempt from liability for minor mistakes that do not result in unlawful exemption from or reduction of customs duties and taxes and/or applicable non-tariff regulation measures.

Furthermore, if, as a result of the documentary audit, decisions on the classification of goods or decisions on adjustment of the declared customs value of goods are cancelled or changed, financial sanctions, penalties and administrative fines do not apply. The exception is when the decisions taken are based on faulty documents and unreliable information and/or when these decisions were taken as a result of the company's providing information that is insufficient for taking the relevant decision.

In terms of visible simplifications of law enforcement procedures, the Code introduces voluntary settlement (compromise) for disputes related to violations of the customs rules. In the case of a compromise, the customs authorities can terminate the proceedings in a case and the person who has violated the customs rules must pay the required fine and/or abandon the imported goods in favor of the state.

Individuals

Long-hoped-for changes to the limits for duty-free import of goods by individuals have been adopted. Goods imported by individuals by air in accompanied luggage with a customs value not exceeding €1,000 (or €500 by sea or land) and goods imported via international post and unaccompanied luggage with customs value not exceeding €300 are exempt from import duties and taxes. Import of goods with customs value exceeding these amounts, but not exceeding €10,000, is subject to a 10% import duty and VAT. Import of goods with customs value exceeding the €10,000 limit is subject to general customs clearance procedures.

Closing thoughts

The new Code shows significant progress in developing customs procedures and harmonizing them with best European practice. It is worth noting that Ukrainian law often depends on how the state authorities actually implement it. Ukrainian lawmakers have thus put much effort into specifying detailed rules and provisions into the new Code. Although the new Customs Code is not a cure-all solution for all of the complexities that regularly manifest themselves at the border, it will hopefully lead to a wave of positive changes in both regulations and practice.

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South Africa

New income tax return requirement creates customs challenges and opportunities



The South African Revenue Service (SARS) recently implemented a supplemental declaration, the IT14SD, to support certain values on the taxpayer's income tax return using customs, value-added tax and "pay as you earn" information. Businesses are becoming aware that completing the seemingly simple IT14SD fields related to customs values is not a mere administrative formality. On the contrary, soliciting, analyzing and reconciling the necessary information requires substantial time, effort and cost.

We discuss below some of the customs challenges businesses are experiencing as they address the new income tax requirement as well as opportunities to take advantage of the additional efforts.

Systems limitations

Part of the challenge stems from limitations of current information systems. Detailed reports or accounts relating to imported and exported goods have never before been a requirement for businesses. The granular data pertaining to customs declarations usually resides with clearing and forwarding agents whose systems have primarily been designed for the electronic submission of the customs declaration to SARS. While many of these systems do have reporting capabilities of various degrees, it is often not a quick or effortless exercise to draw the data required for the accurate submission of the IT14SD information.

A complex reconciliation exercise

The IT14SD ostensibly seeks to compare the declared customs value of imported and exported goods against the cost of sales. In practice, however, the reconciliation exercise can be complex. This is because merely documenting the values as per the customs clearance documents and that of international purchases will not reconcile due to a variety of adjustments that need to be accounted for. We highlight some of these adjustments below.

Currency conversion

Trade transactions are often in a foreign currency denomination rather than the South African rand. For customs purposes, legislated currency conversions are taken at the "shipped-on-board" date (i.e., the date at which the goods were placed on board the vehicle removing it from the country of exportation). For the cost of goods determination, typically, the value of the goods will be converted at the prevailing rate of exchange secured by the seller or the buyer, depending on the Incoterms related to the transaction. This value may be exacerbated by factors, such as whether the purchase was made using a spot rate, forward exchange contract or an internal treasury function that may use a combination of various strategies. Therefore, to get the value to a common item, the taxpayer would require detailed information relating to each and every transaction.

Customs adjustments to the purchase price

Further, depending on the Incoterm used, there are various costs, charges and expenses that may be included in, or excluded from, the purchase price of the goods. Accordingly, such amounts must either be added to or subtracted from the purchase price in determining an appropriate customs value. The costs, charges and expenses can be numerous and include items such as inland freight, packing and stuffing costs, taxes in the country of export, inspection charges, freight, insurance and the list goes on. In many cases, it has not been required that importers account for these costs, charges and expenses separately, and therefore the full purchase price of the goods, which often is not the customs value thereof, will be posted to the cost of sales. Again, in order to accurately document these values on the IT14SD, the taxpayer would require detailed information on the transactional level for each of these costs, charges and expenses (often in a foreign currency). Unless the company runs a very detailed logistics accounting system, this information is extremely difficult to obtain, and it takes significant time to identify and understand given the sheer quantum of information that needs to be analyzed.



Retroactive transfer pricing adjustments and the consequent adjustments to the customs value declared upon importation (or lack thereof) is another area of potential discrepancy between the cost of sales and the customs value, and a very challenging one.

Implications of certain customs planning mechanisms

Another issue we have identified is that there are timing implications that would render the comparison of imported goods during a period and the final allocation of cost of sales amounts in another period unreconcilable. These timing differences include customs planning mechanisms such as bonded warehouses and rebate facilities. For example, goods imported in year one may be stored in the bonded warehouse for a period not exceeding two years from the date of importation of the goods. Therefore, if the goods are removed from the bonded warehouse two years later, the final cost of sales will only be determined at the time the goods are sold, as ostensibly storage costs, handling costs and delivery costs may be posted to the cost of sales at that time, depending on the company's accounting policies. This is exacerbated, as there would also be further goods being placed in the bonded warehouse, and other goods removed there from various periods.

Export reconciliation

The reconciliation of the exports may be a little more straightforward; however, there are certain assumptions the taxpayer will be required to make. For example, sales to customers in the South African Customs Union (SACU) are considered exports from a VAT perspective, but the process is largely considered to be a domestic transaction from a customs perspective. Therefore, in order for a company to declare SACU sales as a reconciling item for goods that were removed from a bonded warehouse, the information may or may not be reconciled based on whether the export sale has been standard rated or zero-rated from a VAT perspective.

Risks

Performing these reconciliations is perhaps possible in theory, but SARS has given the taxpayer a mere 28 days to provide the reconciliation. Within this period it seems that there are very few (if any) taxpayers that would currently be able to provide a properly detailed and reconciled IT14SD. This is due to the fact that in most cases, the taxpayer would be required to create the source data from various reports and from various parties in order to provide an accurate supplementary declaration to SARS.

As this is a declaration made by the taxpayer, it is the taxpayer who runs the risk of having additional assessments raised based on the IT14SD amounts. In many cases, SARS has been initiating audits of taxpayers and requesting highly detailed information pertaining to specific areas of the submitted IT14SD. Accordingly, it is important that taxpayers take caution when completing the IT14SD reconciliations and be prepared with supporting documentation to explain any discrepancies.



Every cloud has a silver lining

The IT14SD, as an additional reporting requirement to the annual income tax return, will become a recurring exercise. Recognizing and accepting that, companies are looking into long-term solutions to comply with this new requirement.

From an information systems standpoint, the relevant data collection can be automated to enable timely completion of the IT14SD. At the same time, the availability of this information can also be used by the company to enhance visibility of the customs values and duty cost in order to better identify duty savings strategies. Additionally, the data collection can be used to monitor customs clearance and benefit overall customs compliance. Regular interim checks may reveal abnormal customs values declared or trends in procurement and import/export performance. This proactive approach gives the company more possibilities to take corrective action in a timely manner and manage the risk of exposure to additional assessments and penalties.

The IT14SD reporting requirement may therefore lead companies to develop better internal control mechanisms, thus creating enhanced visibility and serving as a risk management tool to monitor the customs duty performance.

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