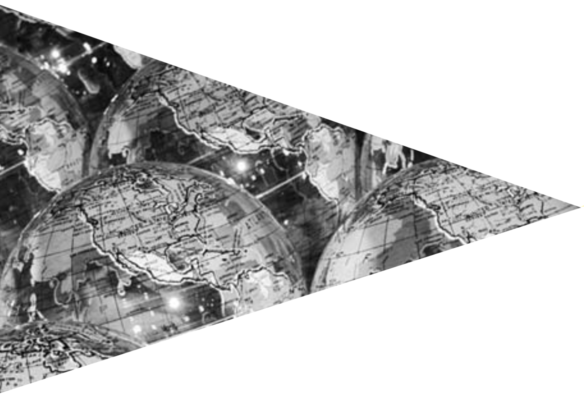
March 2011, Volume 10, Issue 1

TradeWatch



In this issue

ERNST & YOUNG

Quality In Everything We Do

The European Union's new preferential rules of origin under the Generalized System of Preferences

Under its Generalized System of Preferences (or GSP) arrangements, the European Union (EU) grants preferential import duty access into the EU market for materials and products from 176 "developing" and "least developed" countries and territories worldwide. As well as indigenous products from these countries, such as animals or vegetable products grown there, the preferential GSP rate can be applied to products that have been manufactured in a GSP country from imported materials provided a rule of origin, defined in the EU Customs Code for that product, has been met.

On 1 January 2011, the EU significantly relaxed the GSP rules of origin. Overall, the objective of the changes – introduced by EU Commission Regulation (EC) 1063/2010 (18 November 2010) – is to make it easier for manufacturers and suppliers in GSP countries to qualify products made by them for the EU GSP preferential duty rates, thereby giving them a financial advantage compared to suppliers in developed countries while also supporting and promoting economic processing activity in the GSP countries.

At the same time, some of the changes that are being introduced — ostensibly to counter GSP fraud — will create additional financial risks for genuine exporters in GSP countries and for their customers in the EU, which should not be underestimated.

We highlight some key aspects of the changes below.

Changes to the preferential rules of origin

The rules of origin are an essential component of the GSP program and set out criteria that must be met for a product to gain access to GSP preferential treatment. Under these rules, natural and farmed products of the GSP country will generally qualify, but so too can products manufactured in a GSP country from imported materials or components.

There have always been some tricky areas under the previous GSP rules, which have now been recognized as being too onerous. Take, for example, fisheries products. Previously, the GSP criteria required that at least 75% of the crew of a fishing vessel be nationals from the GSP country (EU citizens could be counted toward this). Under the new rules, this condition has now been removed and there are many similar simplifications in other sectors.

For manufactured items incorporating imported components or materials, the original intention had been to radically change the origin rules to a very simple and broadly applied "added value" test with two local added value thresholds. Both of these thresholds are set at levels that would achieve the objective of making it significantly easier to qualify, depending on the sensitivity of the product and/or whether the supplier was in a least developed country (or LDC).

As an example of the relaxed rules and the difference between LDC and non-LDC countries, motor cars or motorcycles made in an LDC GSP country can now have almost twice as much foreign inputs as under the previous rules. For instance, if the export price of a motorcycle is EUR 4,000, the new rules allow foreign inputs up to EUR 2,800 and even more in certain circumstances, compared to the previous limit of EUR 1,600 (which was also conditional on locally sourcing at least a matching value of components). For non-LDC, the change is less pronounced, allowing up to EUR 2,000 in this example. But here again, the secondary local components condition has gone.

For many sectors and products, LDCs now have two advantages:

1. Under the GSP preference scheme, products from LDCs always qualify for a zero duty rate whereas for non-LDC GSP countries, some "sensitive" products only get a 3.5% duty reduction. For example, GSP-qualified cars imported from an LDC would be subject to a 0% duty whereas from a non-LDC the GSP rate would be 6.5% (based on the normal duty rate of 10% for non-preference sources).
2. The new origin rules now have differential origin qualification for LDC countries for some products; see the example given.

Depending on the sector, the GSP origin criteria now involve one or a combination of the following:

- A limit is placed on the value of imported materials. For example, imported materials must not exceed 50% or 70% of the export price (in effect requiring a particular level of local added value – in the examples, 50% or 30%, respectively).
- A requirement that the finished product has a different tariff classification code than the imported materials (in these cases, the process to classify the materials and end product becomes critical).
- For some products, the rules define specific working or processing that must be done in the GSP country (i.e., the product cannot qualify if these activities are done outside the GSP country).
- For other products, there is a requirement that some specified materials used in the manufacture of the product to be exported to the EU must be "wholly obtained" in the GSP country (i.e., not foreign or derived from foreign inputs). For example, olive oil can only get GSP preference if it is made from olives grown in the GSP country.

While the new rules do lower the qualification criteria, they are still arguably far too complex and this will likely cause problems over time, especially taking into consideration the shift of risk to exporters/importers, which we address later.

Changes extending cumulation

Cumulation refers to a concession, which allows the GSP exporter to treat certain foreign content as if it were local content when applying the origin rule.

Under the previous rules, there were just three situations where cumulation applied and, in practice, there were often technical constraints in the rules that limited the extent to which it could be used in practice:

1. Generally, cumulation could be applied to any EU materials/components that were exported to the GSP country and used in the manufacture of products that were then re-exported to the EU.
2. A similar treatment applied to materials from Norway and Switzerland.
3. There were three groups of GSP countries defined as regional cumulation zones where materials/components from any country within the group could be counted as local content in another country of the same group.

The revised rules have made quite a number of changes to cumulation with the aim of making it easier to qualify (albeit with some sensitive products specifically being excluded from the regional cumulation concession). For example, the "Norway/Switzerland" treatment is being extended to materials from Turkey and the rules also allow for further extensions to more countries with which the EU has free trade agreements, although there are some formalities before this will take effect.

Also, another regional cumulation zone has been added comprising the MERCOSUR countries (Brazil, Argentina, Uruguay and Paraguay) and some of the technical rules on cumulation within the defined regional zones have been simplified to remove practical obstacles. There is also now some scope for using cumulation between the different regional zones.

For companies that can navigate the cumulation rules successfully, the changes open up significant new opportunities to gain access to the GSP arrangements where materials and/or intermediates are sourced in multiple countries. But, as can be appreciated from even this summary, the rules are far from simple and companies should take care to check carefully how this process is being applied by their affiliates or suppliers as part of their origin validation processes.

Logistical simplifications

Another innovation in the new GSP changes is that the "direct transport" rule, which required that the product move under a single transport document to the EU, has been replaced with a new principle of non-manipulation (i.e., provided the EU importer can establish the identity of the products and satisfy the customs authorities that they were not altered or transformed in an intermediate country, the GSP preference can now be maintained).

Under this new rule, storage of products and splitting of consignments can take place in an intermediate country under supervision of the local customs authority there. This will mean that GSP benefits can be maintained even where the products move through regional distribution hubs, for example.

Move to GSP exporter self-certification

To be phased in over a longer time period, the reform will involve a new self-certification system for proving GSP origin eligibility, which will require exporting companies in GSP countries to sign up to a new electronic system called REX (for registered exporters) that will be accessible to EU customers. REX will also become the basis for determining origin of EU and other materials used for cumulation as described above.

The changes in the new regulation represent more than a procedural change, however, and exporters and importers are advised to consider this very carefully from a risk management perspective. In effect, the obligation to check origin qualification in advance — and the commercial and financial consequences if this turns out to be incorrectly determined — is essentially being shifted away from the customs administration side onto the exporter and especially onto the importer who will become liable to the customs authorities retrospectively for any errors as well as potentially bearing any commercial downside based on future additional duty costs.

From an EU perspective, the preamble to the regulation makes clear that this has always been one of the main aims of the reform. Currently, where the declared origin proves to be incorrect, GSP benefits that have already been granted to an EU importer generally cannot be rescinded or clawed back by the EU customs authorities; this is on the basis that the importer is generally deemed to have acted in good faith and, unless it turns out that the GSP exporter(s) fraudulently misled the authorities in the country of export, the error that led to the granting of a GSP preference (which effectively represents a financial loss to the EU budget) is attributed to the competent authorities in the GSP country that stamped the origin certificates for the exports.

The solution in the new rules is to remove the competent authorities from any responsibility, placing the obligation for correctly determining the origin solely on the GSP exporter who will provide statements on origin to EU customers, not certificates stamped by the authorities. In the event that it is later determined that the origin was not correctly ascribed, there are adverse consequences for both the GSP exporter (who can be de-listed from REX for any future exports) and for the EU importer (who will generally be liable for retrospective duty assessment [i.e., any GSP benefits already received will be re-assessed]).

Thus, in particular for EU importers with significant levels of GSP import, some additional due diligence may be merited to guard against the new financial risks, which could otherwise result in additional unbudgeted duty costs for future imports as well as duty being reassessed retrospectively (which would typically involve the previous three years' imports). This could include a review of both contractual arrangements with GSP suppliers as well as less legal, but equally important, supplier support and checking processes (e.g., to establish whether suppliers that will have to provide GSP origin statements do actually understand the EU GSP requirements and have processes in place to prevent and detect errors and risks). Many companies that use GSP already provide support and training where the suppliers' own resources are weak and this will become even more important in the future.

Until REX is fully operational — which will not be until January 2017 at the earliest to allow exporters and authorities prepare and to get the infrastructure in place — the current system of origin certified by the GSP competent authority will continue.

Concluding thoughts

The changes to the GSP rules of origin significantly increase the opportunities for reducing costs on any materials or products that are subject to positive duty rates when imported into the EU, but there are new commercial and financial risks that companies need to consider.

The benefits of GSP preference are generally a full exemption from duty either if the source country is a LDC or the product is on the non-sensitive list. Even sensitive product from non-LDC countries typically get a duty reduction amounting to 3.5% of the value of the goods. Taken together with lower production costs in these countries and what are now relatively low local content requirements, this is an excellent time for companies to revisit GSP sourcing and manufacturing options from which to supply the EU market.

Effective immediately, the thresholds for added value or other conditions attaching to GSP origin qualification have been very significantly reduced and many practical and procedural obstacles have been removed or eased. There is now real scope to plan and use cumulation where activities are carried out in multiple countries.

We would very definitely sound two particular notes of caution.

- Firstly, despite the stated intentions of the drafters, it is difficult for anyone reading the new EU GSP origin rules to come to a conclusion that the goal of simplifying the rules (as opposed to easing the qualification conditions) was achieved. So, while there are definitely much greater opportunities to gain access to GSP benefits, companies must be realistic about the need to have internal controls in place to make sure the rules are correctly identified and applied. Apart from the more technical aspects such as cumulation, this also applies to the fact that there remain so many different qualifying rules for different products (and bear in mind that exporters will have different qualifying rules for the same product going to different destinations that offer GSP benefits, such as US, Canada, Australia, and even places like Russia and Kazakhstan).
- Secondly, the scope for significantly extended GSP benefits has to be balanced with the need for much greater risk management, which may include a need to introduce more elaborate due diligence processes. Indeed, this will become critical with the move to self-certification, which will shift the cost burden of any error onto the exporter and its EU customers who may find themselves facing retrospective reassessments as well as losing future benefits due to errors made by their GSP suppliers.

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Argentina

Customs authorities clarify the criteria applicable when converting tax obligations into Argentine currency

The Argentine customs authorities recently issued General Instruction No. 7/2010 to clarify the criteria applicable when converting tax obligations into Argentine currency. For companies that have encountered this issue with respect to customs surcharges concerning import/export operations performed prior to 2002, the new guidance brings resolution to the long-standing dispute.

As background, Decree No. 214 (the Decree), issued in 2002, established the criteria for converting tax obligations into Argentine currency (i.e., Argentine pesos or ARS) as a response to the economic and financial crisis, when the Argentine peso was no longer pegged to the US dollar (USD). The Decree included the requirement that all outstanding payables and obligations stated in USD that were not yet converted into Argentine pesos, shall be converted at an exchange rate of USD 1 to ARS 1. Additionally, the Decree established the application of the CER (benchmark stabilization coefficient), which is determined by the Central Bank of Argentine. This provision intended to protect the creditors of outstanding obligations stated in USD by preventing those receivables from losing purchasing power due to the crisis.

In Argentina, customs duties are calculated in USD and converted into ARS at the time of payment. Pursuant to the Decree, any customs surcharges concerning import or export transactions conducted prior to the Decree must be converted into ARS applying the CER. However, the actual application of this coefficient was not always clear.

For example, where the customs authorities have identified undervalued goods related to import or export transactions that occurred prior to the 2002 Decree, a notice would have been presented to the taxpayer indicating the amount of customs surcharges due. In many instances, the notice stated the amount of the surcharges in ARS with no reference to the CER. The taxpayer then assumed that the obligation had already been converted to ARS, so that the application of any coefficient would not apply. On the contrary, the customs authorities argued that the coefficient should be included in the final calculation of the amount payable, with the effect of increasing the total amount due — a costly consequence for the taxpayer.

This application of the CER was widely discussed in various administrative and legal proceedings by the taxpayers seeking to overturn the position of the customs authorities. Eventually, case law started to consistently adopt the criterion that CER was not to be applied to a customs surcharge at a later legal stage in those cases in which the customs authorities had not made any reservation in such regard (e.g., no reference was made to the CER in the notice).

In August 2008, the Argentine Supreme Court of Justice, in agreement with the opinion issued by the Argentine Attorney General in the case of Editorial Perfil S.A. c/DGA s/Apelación (Editorial Perfil S.A. v. DGA [Argentine customs authorities] on appeal), confirmed the criteria adopted in the prior cases, stating that the provisions of Decree No. 214/2002 did not apply to obligations not expressly stated in USD, this is to say, those already converted to Argentine pesos.

Irrespective of this consistent treatment by the courts, in practice some of the administrative decisions continued to require that the CER be used in calculating the taxes originally assessed in ARS. As a result, importers and exporters were forced to litigate the issue at a higher court or administrative proceeding, at great expense to the taxpayers and a drain on resources for the courts to assert rights that case law had already consistently established.

Finally, there is new relief for taxpayers. In late 2010, the Argentine customs authorities issued General Instruction No. 7/2010 whereby they instructed the relevant areas in its organizational structure to apply the criterion arising from the Editorial Perfil S.A. v. DGA ruling.

Pursuant to this General Instruction, the legal counsel representing the tax authorities are expressly authorized to allow the claims or remedies filed by the importers or exporters regarding the improper application of the CER, and they are also instructed not to appeal the rulings dismissing the use of this coefficient in calculating the taxes under review. In addition, in view of the General Instruction, administrative judges are required to resolve the challenge proceedings, the contentious summary proceedings and the reimbursement proceedings in progress based on this authoritative opinion.

The General Instruction also provides that all final resolutions contrary to this now established criterion shall be rendered ineffective, and new resolutions in conformity with this criterion shall be issued. Still, the opportunity to seek a refund for any amounts paid in excess due to this situation would depend on the particularities of each case.

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Chile

Chile as an export platform country

During the last decade, Chile has entered into 20 free trade agreements (FTAs) that cover 59 countries, representing 85% of the world's gross domestic product (GDP), 65% of the global population and approximately 90% of global commerce. This vast range of FTAs brings an average effective customs tax rate of 0.4% for exports from Chile. For business, these figures can translate into considerable cost savings, which is why many companies are looking to Chile as an export platform country.

Accessing preferential tariffs in export markets

In order to benefit from preferential access to the wide range of export markets covered in Chile's FTAs, a product must qualify under the specific FTA's rules of origin. To truly take advantage of an FTA, it is important that businesses consider that "origin" in this context refers to the economic nationality of a product, not from where it is shipped. At the same time, a product does not need to be wholly obtained in Chile, but rather can be imported into Chile with enough transformation or value added pursuant to the applicable rule of origin so that the product manufactured or processed for export confers Chilean origin.

Generally, the origin status is based on one of the following requisites, based on the degree of transformation, as follows:

1. Goods wholly obtained from Chile
2. Merchandise produced from materials from Chile and the FTA signatory country
3. Products manufactured with non-originating inputs coming from a non-signatory of the FTA, provided they comply with tariff change and/or regional value content requirements

All the FTAs have their own origin requisites, whether general or specific, establishing the transformation or "value added" requirements necessary for the final product to qualify for preferential tariff rates in the FTA signatory country.

As a typical example, a company may establish operations in Chile by either incorporating an affiliated company in Chile or, in qualified cases, establishing a joint venture with a local company (based on various business, legal and tax considerations). The Chilean operation imports duty-free inputs, such as raw materials, components or semi-finished products from countries that are FTA signatories. The transformation or "value added" required by the specific rule of origin is effected in Chile and then the finished product, of Chilean origin, is exported duty-free or at preferential duty rates to one or possibly multiple countries with which Chile has entered into an FTA.

Each rule of origin, of course, must be separately assessed to determine qualification under a particular FTA. There are, however, commonalities among the variety of rules of origin, resulting in a number of instances in which business operations can qualify for multiple FTAs regardless of the origin of imported component parts. Successful operations have been established for a wide variety of businesses, including:

- Paper rolls and auto-adhesive film
- Automatic machines for the production of confectionary and chocolate products
- Robotic arm for cleaning mining furnaces
- Tires
- Food pastes
- Fruit juices
- Gearboxes for motorized vehicles
- Explosives and detonators for the mining and petroleum industry
- Canned fish
- Leather suitcases
- Shoes
- Jewelry articles

Importance of origin due diligence

Sizeable cost savings can be found inside Chile's FTAs. However, it can be challenging to actually determine whether a product qualifies to enjoy preferential tariff benefits. Origin is generally the most complicated aspect of an FTA, requiring the highest degree of technical understanding and/or professional support. Therefore, it is important that businesses conduct sufficient due diligence to ensure a product actually does qualify before establishing export platform operations in Chile.

Further, an expert view of the various FTA rules of origin as they apply to a particular product can uncover sourcing and processing options that allow flexibility for operations while still meeting the origin requirements. A comprehensive origin analysis is an important exercise in due diligence that promotes and ensures origin qualification to gain more competitive access to third countries.

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El Salvador — Central America

Customs authorities taking aggressive approach on the addition of royalty payments in the customs value

The customs authorities in the Central America region, and most notably, El Salvador, have become very interested in royalty payments made by the importer. Under customs valuation rules, certain royalty payments are required to be included in the declared customs value. The customs authorities are using this requirement to impose assessments for additional duty and import taxes as well as fines, surcharges and interest, which has alarmed many importers.

Royalty payments as an addition to the value of imported goods

The customs valuation rules for the countries of Central America, Panama and the Dominican Republic are based on the World Trade Organization (WTO) Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade (Valuation Agreement). Pursuant to the Valuation Agreement, transaction value is the preferred method for determining the customs value of imported goods. The transaction value is the price actually paid or payable for the goods when sold for export to the country of importation, subject to specified adjustments, such as certain royalty payments.

The Valuation Agreement provides that royalties paid by the importer must be added to the price paid for the product to determine transaction value when the royalty (1) is related to the imported product, and (2) must be paid as a condition of the sale to the importer. Such additions to the price paid or payable must be made on the basis of objective and quantifiable data.

The royalty controversy

A controversial issue for importers is the "condition of sale" determination when the royalty is paid by the importer of product to someone other than the seller of the product. In this respect, the customs authorities are taking an aggressive position to include such payments in the customs value.

For example, recently in El Salvador, the Administrative Court of Appeals confirmed on November 2010, the position issued by the customs authorities that treated royalty payments as an addition to the customs value, even though:

a) The royalty agreement was signed by an entity other than the supplier of the product.

b) The royalty was paid for marketing strategies and support in finance and accounting, which are items that arguably do not refer to a condition of the sale of imported product.

c) The amount to be paid under the concept of royalties could not be determined at the time of importation of the goods, but after the sale of the product in the local market.

Implications for business

In today's economic environment, there is strong pressure for government agencies, such as the customs authorities, to increase revenue collection. For some importers, assessments for undervalued import declarations can be material, considering that the customs authorities can collect underpaid duties and impose fines, surcharges and interest on that amount retrospectively for imports made during the last two to five years (depending on the Central American jurisdiction). Accordingly, it is important that importers review the correctness of their customs values on past and current imports, and assess their position as to the customs treatment of any royalties paid.

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Mexico

New trade rules and restrictions for IMMEX operations also bring new benefits for Empresa Certificada companies

On 24 December 2010, the Mexican government published in the Official Gazette numerous amendments to the "Decree for the Promotion of the Manufacturing Industry, Maquiladora and Exportation Services" (IMMEX Decree). On the same date, the Mexican government also published amendments to the General Foreign Trade Rules (GFTR). These amendments include some significant new trade-related changes and restrictions for IMMEX operations and also grant new benefits to entities that are registered in Mexico's voluntary compliant importer program, known as Empresa Certificada.

Trade-related amendments to the IMMEX Decree

Revised definition of "maquiladora activities"

The amendments to the IMMEX Decree have arrived after many months of speculation, and almost a year after proposed draft modifications were originally made available for public comment. Much of the focus has been on the new revised version of Article 33 of the IMMEX Decree, which redefines what qualifies as "maquiladora activities" for income tax purposes. This provision is generally viewed as an anti-abuse measure to limit unintended taxpayers from benefitting from the various income tax-related benefits afforded by the program.[1]

From a customs standpoint, IMMEX companies can continue to use domestic materials and components, as well as materials and components that were not imported under the temporary importation regime, provided that such materials and components are exported after being incorporated into the finished products. In this respect, there is some relief, as the new definition does not include the proposed language, which would have required that a majority of raw materials be imported (rather than locally sourced) in order to qualify for the definition of "maquiladora activities."

It is worth noting that even though for purposes of the new "maquiladora activities" definition the return abroad of waste and scrap is not required; the customs requirements for scrap and waste have not changed. Accordingly, IMMEX companies must either return abroad or nationalize the generated waste and scrap.

New restrictions on steel and iron and other "sensitive" goods

A primary trade-related amendment to the IMMEX Decree places restrictions on temporary importations of steel and iron goods with the addition of Annex I TER. The new Annex I TER classifies steel and iron products under chapter 72 of the Mexican Harmonized Tariff Schedule as "sensitive" goods. This change is significant given that sensitive goods may only be temporarily imported by IMMEX companies for up to nine months, instead of the generally applicable 18-month temporary importation period.

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[1] For additional information on the income tax-related implications, see the Ernst & Young International Tax Services publication "Mexican government enacts important changes to IMMEX (formerly Maquiladora) regime" dated 30 December 2010, available at http://www.eyboletin.com.mx/eysite2/pdf/comentarios_832.pdf

Additionally, the amendments provide that IMMEX companies must file a modification to their IMMEX authorization if they incorporate any of the steel and iron goods listed under Annex I TER of the IMMEX Decree into their manufacturing processes. As background, IMMEX companies were, in practice, already exempt from filing an amendment to their program when incorporating into their manufacturing processes any additional goods listed under article 4 of the IMMEX Decree (fuels, lubricants, raw materials, parts and components, etc.), which were not originally approved in their IMMEX authorization. The amended IMMEX Decree formally recognizes such exemption under Article 6 BIS; however, such exemption does not apply for sensitive goods listed under Annexes I BIS (sugar) and I TER (steel and iron).

These new restrictions on steel and iron goods will take effect on 24 March 2011. The Ministry of Economy will issue specific regulations regarding the requirements that must be met to perform the temporary importation of sensitive goods. In this regard, the amended IMMEX Decree also states that a joint visit by the Ministry of Economy and the Tax Administration Service shall be conducted prior to approving an IMMEX Program for the temporary importation of sensitive goods.

Significantly, the amendments expressly provide that the above mentioned restrictions will not apply to IMMEX companies that are also certified as an Empresa Certificada. Such companies may temporarily import sensitive goods for an 18-month period and are not required to file an amendment to their IMMEX authorization when incorporating Annex I TER goods into their manufacturing processes.

Elimination of ALTEX and ECEX export incentive programs

The amended IMMEX Decree also eliminates the high volume export company program, known as ALTEX and foreign trade companies program, known as ECEX. These programs provided various export incentives for participating companies. Previously authorized ALTEX and ECEX companies can continue to benefit under the program as long as program requirements are maintained.

Going forward, IMMEX companies operating under the Services modality, which are also registered as an Empresa Certificada, can likely achieve the same objectives that had been provided under the eliminated programs, specifically the accelerated value-added tax (VAT) refund for taxpayers with favorable VAT balances.

Amendments to the GFTR

New restrictions on virtual transfers

The amendments to the GFTR place new restrictions on virtual transfers, i.e., goods already in Mexico transferred to an IMMEX company from a foreign resident or other IMMEX company. Rule 4.3.25 of the amended GFTR now states that IMMEX entities that receive goods transferred through virtual "pedimentos" or entry documents must return abroad or permanently import such goods within a six-month period. This requirement does not apply to IMMEX entities that receive goods from national suppliers or when dealing with fixed assets. Also, if the IMMEX entity is registered as an Empresa Certificada, the six-month period will not apply.

Additionally, the GFTR now specifically provides that inventories may not be transferred through virtual operations when they remain in the same state as when they were temporarily imported into Mexico, unless they are transferred by an IMMEX entity under the Services modality. This restriction applies even if the entity is certified as an Empresa Certificada company.

Extended temporary importation periods for Empresa Certificada companies

A notable addition to the GFTR is Rule 3.8.4, section XXVII, which states that IMMEX entities, which are registered as an Empresa Certificada, may maintain their temporarily imported goods in Mexico for as long as 36 months, going well beyond the general 18-month temporary importation period. Also, IMMEX entities registered as an Empresa Certificada under Rule 3.8.1 numeral H of the GFTR (i.e., IMMEX entities that manufacture products in the electrical, electronics, auto parts and automotive industries and which operate under the "SECIIT" sectoral scheme) may maintain their temporarily imported goods in Mexico for up to 60 months.

Affected companies can already benefit. The rule provides that IMMEX entities registered as an Empresa Certificada may apply these new temporary importation periods to current inventories as long as they remain within the original temporary importation period (i.e., 18 months) and the IMMEX entity is not being subject to an audit by the tax authorities.

More flexibility for repair or maintenance of temporarily imported machinery and equipment

The new rules also provide some welcome flexibility with respect to temporarily imported machinery and equipment in need of maintenance or repair. Rule 4.3.7 of the GFTR now states that IMMEX entities may transfer temporarily imported machinery and equipment to non-IMMEX entities for their repair or maintenance, as long as notice is filed before the corresponding local Tax Audit Administration. The machinery and equipment may remain for up to six months in the facilities of the non-IMMEX entity and such term may be extended for another six months if due notice is given to the corresponding local Tax Audit Administration.

Limited opportunity to reduce fines

It is important to note that the amendments provide for a limited and partial reprieve from the stiff fines assessed on temporarily imported goods that have exceeded their allowable time period. Specifically, for a period of six months after the amendments to the GFTR enter into force (25 December 2010), entities which temporarily imported goods into Mexico and whose temporary importation period has expired may perform the regularization of such goods. Importers must perform the virtual permanent import of the goods, paying updated omitted duties, VAT and surcharges along with a fine of USD 40 to USD 60 for each 15-day period counted from the date when the goods should have been returned abroad or permanently imported. This represents a 70% reduction in the payment of the statutory fine.

Implications for business

We have highlighted some of the primary trade-related changes to the new IMMEX Decree and GFTR. Overall, the new rules serve to tighten controls over some aspects of the IMMEX program, such as sensitive goods and virtual transfers, while at the same time increase benefits for IMMEX companies that are registered in the Empresa Certificada program. With longer temporary importation periods and less restrictions on sensitive goods, Empresa Certificada provides IMMEX operations with more flexibility for supply chain operations.

Additionally, the rules provide a limited opportunity for IMMEX companies to report any non-compliance due to exceeding temporary importation periods with reduced fines. Now is the time to review your IMMEX compliance, consider how the new rules impact your IMMEX operations and consider taking advantage of the Empresa Certificada program.

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United States

Human Resources meets US export controls: the new US I-129 Form and what it means for your company

On 23 November 2010, US Citizenship and Immigration Services (CIS) introduced human resources departments everywhere to the world of export controls. CIS published a revised version of Form I-129, Petition for Nonimmigrant Worker, which now requires employers seeking H-1B, H-1B1, L-1 and O-1A work visa classifications for employees to complete a "Certification Regarding the Release of Controlled Technology or Technical Data to Foreign Nationals" in Part 6. The new form was originally scheduled to take effect on 23 December 2010, but was postponed until 20 February 2011, presumably due to the volume of commentary from companies struggling to implement the changes and coordinate the efforts of two separate departments that historically have had little interaction. Employers seeking to obtain a work visa classification for a foreign national employee have two options when completing the newly implemented Form:

1. A license is not required from either the US Department of Commerce or the US Department of State to release such technology or technical data to the foreign person; or
2. A license is required from the US Department of Commerce or the US Department of State to release such technology or technical data to the beneficiary and the petitioner will prevent access to the controlled technology or technical data by the beneficiary until and unless the petitioner has received the required license or other authorization to release it to the beneficiary.

The instructions for Form I-129 provide only limited guidance on the requirements pertaining to deemed export licensing. Employers who have not previously classified their technology and implemented a comprehensive Export Management Compliance Program should move quickly to ensure compliance with the new certification requirements.

What employers need to know

US export control laws are primarily administered by the US Department of Commerce, Bureau of Industry and Security (BIS) and by the US Department of State, Directorate of Defense Trade Controls (DDTC). BIS administers the controls that apply to dual-use items, which are predominantly commercial items with a potential military, nuclear or other prohibited end-use. Dual-use products, software and technology controlled by BIS are listed in the Commerce Control List (CCL), which is part of the Export Administration Regulations (EAR). DDTC administers the controls applicable to defense articles that are primarily for military use. The defense articles controlled by DDTC are listed in the US Munitions List (USML), which is part of the International Traffic in Arms Regulations (ITAR).

Under the EAR and the ITAR, an export of technology, technical data or source code is "deemed" to take place when it is released to a foreign national in the United States. Technology is considered released when it is made available to a foreign national for visual inspection, when technology is exchanged orally or when technology is made available by practice or application. Deemed exports are the target of the new I-129 certification requirement. When a foreign national employee needs access to controlled technology, technical data or source code, companies may be required to obtain the necessary license from the applicable governing agency. In order to determine whether a license is required, companies must review the CCL and the USML to determine if their technology or technical data is controlled. Controlled technology may not always require a license before being released. The analysis will vary depending on which country the foreign national employee is from. It should also be noted that the treatment of dual nationals (those having citizenship or permanent resident status in multiple countries) varies between the EAR and the ITAR.

What employers need to do

Export compliance and human resources functions are generally housed in separate departments with limited or no interaction. Post 20 February 2011, this reality must shift in order for companies to develop the policies and procedures necessary to comply with the certification requirements of Form I-129. While the most effective and efficient means to address this risk area varies based on industry and business, key components of a successful integration of these functions may include the following:

1. A mechanism to identify whether controlled technology is created or used by the company
2. A procedure to determine which positions within the company provide access to such controlled technology or technical data (technical positions)
3. A procedure for determining licensing requirements for technical position candidates
4. Technology control plans
5. Offer letters containing language that makes employment contingent on the worker's ability to receive lawfully US technology necessary for the job
6. Internal training and education on deemed export requirements for hiring managers, HR professionals and other necessary company personnel
7. Policies and procedures documenting the due diligence completed by the company before certifying a Form I-129

Companies with an existing Export Management Compliance Program should review and update the program to incorporate HR personnel, and document a plan of action for completing the Form I-129. If not already a part of the program, deemed export licensing reviews and training should be incorporated as soon as possible.

Additionally, companies should not only be concerned about classifying technology and technical data created internally, but should also review technology or technical data that has been generated by third parties and is now in the possession of the company.

The consequences

The certification is made under penalty of perjury, with attendant possible civil or criminal liability on the part of certifying employees and their employer. CIS has not issued guidance detailing how it plans to verify the certification that no license is required or that the foreign national will not have access to it until the appropriate license is obtained. It is instructive to note, however, that CIS' Office of Fraud Detection and National Security (FDNS) already conducts more than 1,000 unannounced site visits per year to ensure employers are complying with H-1B program requirements. In addition, BIS' Office of Export Enforcement has in the past visited US companies in connection with work visas issued to foreign national workers. The United States recently announced creation of the Export Enforcement Coordination Center, which will be part of the Department of Homeland Security. It should be expected that the Export Enforcement Coordination Center will foster improved information sharing between BIS, DDTC, FDNS and other relevant agencies. The purpose of the Export Enforcement Coordination Center is to unite resources from the departments and agencies responsible for investigating suspected export violations by sharing information and resources. While the certification does not change the underlying deemed export requirements, for many employers this will be the first time they will be asked to formally certify compliance for each foreign national hired on an individual basis.

Conclusion

The new Form I-129 and its certification requirements may pose a substantial risk to companies. Companies should work expeditiously to classify the technology utilized in their business, whether developed internally or externally, and implement procedures to ensure their certification for each foreign national employee based on the review and application of export control laws and regulations.

For additional information, contact Matt Bell, *Dallas*, Ernst & Young LLP (United States) at matt.bell@ey.com (Tel. +1 214 969 8378) or Ronald Matten, *Toronto*, Egan LLP, which is allied with Ernst & Young LLP, the Canadian member firm of the global Ernst & Young network at ronald.matten@ca.ey.com (Tel. +1 416 943 2310).

Foreign Trade Zones Board proposes significant regulatory framework revisions

Foreign trade zones (FTZs) are designated areas that are physically located within the US, but considered outside of the US Customs territory. A business operating in an FTZ may receive a number of economic benefits, including:

- Duty deferral on imported merchandise until the merchandise leaves the FTZ and enters US commerce
- Duty avoidance on merchandise imported into and re-exported from an FTZ
- Duty reduction for manufacturing operations realized through lower duty rates where the FTZ user assembles or manufactures products in a zone
- Duty deferral, and possible reduction, related to the importation and assembly of production equipment to be used in the zone

The Foreign Trade Zones Board (FTZB), an interagency board consisting of the US Secretaries of Commerce and Treasury, licenses FTZs based upon a demonstrable need for zone services. The FTZB maintains a public policy objective that anticipates approved zones will create and maintain employment through encouragement of operations in the United States when, for customs reasons, such employment may have occurred abroad. Zones may be either "general-purpose zones" or "subzones." General-purpose zones are typically located at or near major ports of entry (e.g., marine, such as Port of New York or air, such as Dallas/Fort Worth) and offer a broad range of services. Subzones are a special-purpose type of zone where the requested operations cannot be met by the general-purpose zone (e.g., distribution or manufacturing at a private facility). Once approved by the FTZB, zones are operated under the supervision of the Customs and Border Protection.

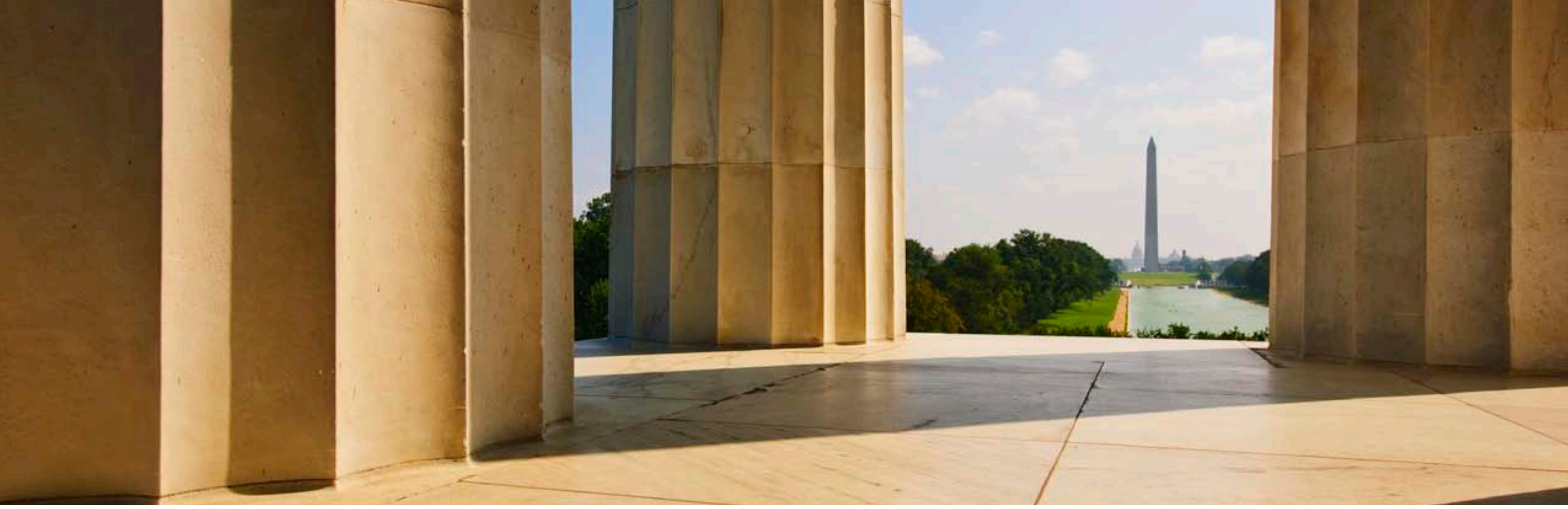
Under present regulations, in place since 1991, all zone activity requests require submission of a formal application to the FTZB and are subjected to a procedural review process. This process typically lasts up to one year or more, although certain types of requests or modifications to existing zone projects may be approved under a shorter timeline. In recent years, the FTZB has recognized that the pace of business and corporate decision-making has accelerated dramatically, and the present process is not conducive to providing responsive actions on zone applications.

The proposed regulations, issued on 30 December 2010, are intended to update and significantly modify the substantive and procedural rules for the authorization of FTZs and the regulation of zone activity. The revisions encompass a number of clarifications and revisions designed to improve flexibility for US-based operations, promote the uniform treatment by grantees to all zone users and strengthen compliance and enforcement. Some aspects of the rules have been controversial.

Improve flexibility for US-based operations

The proposed regulations would focus the current process of advance approval for manufacturing and processing activity occurring in FTZs on those situations:

1. That causes a tariff reduction to a component part incorporated into a finished product (avoiding an inverted tariff)
2. In which production input is subject to an antidumping or countervailing duty order
3. In which a production input is subject to an exclusion order of the International Trade Commission (a Section 337 order), or to a quota
4. In which the production activity will result in duty avoidance on scrap and waste



The FTZB would adopt a new definition for "production activity," which encompasses these concepts, and eliminate current definitions for "manufacturing" and "processing." These revisions are designed to respond to the need for shorter time frames for decisions on production locations (US versus offshore) and the growth in contract manufacturing where the deadline for selection of a US manufacturer anticipating approval of FTZ benefits is not competitive when compared to a foreign manufacturer.

To improve flexibility for applicants and response time from the FTZB in situations where advance approval would be required, the proposed regulations give greater authority to the agency for issuing interim approval while the full FTZB review is conducted. This is an expanded and more comprehensive application of the present temporary/interim manufacturing (T/IM) procedure. T/IM is a policy, not yet subject to specific regulations, in which the FTZB granted expedited approval of zone activity requests that were similar to those approved within the previous five years by the FTZB. The new provisions would not be limited to previously approved similar activity.

The specific approvals for production inputs subject to an antidumping or countervailing duty order varies from that described in prior regulations, but is consistent with recent decisions by the FTZB (see related article on recent FTZB activity).

Promote the uniform treatment by grantees to all users of a zone

The proposed regulations also address issues noted by the FTZB for maintaining continued interest and fairness in zone projects. The FTZ Act requires that each zone be operated as a public utility and that grantees provide uniform treatment to all users of a zone project. The current regulations lack guidance to grantees on practical implementation of these requirements. Under the proposed regulations, guidance would be provided for these requirements along with specific standards for compliance.

One controversial area of the regulations involves the proposed restrictions on third parties who provide services to both grantees and zone users. The proposal would preclude a party who assists a grantee by reviewing or making recommendations on a proposal pertaining to FTZ authority or activation, or who assists with collecting or evaluating annual report data, from offering or providing services to a zone user. The proposed restriction is quite extreme, and is expected to generate substantial commentary.

Strengthen compliance and enforcement

The proposed regulations would also implement the statutory authority to issue fines for violations of the FTZ Act or the Board's regulations. Under current regulations, there are no provisions to address fines for such violations. Certain types of violations are defined by the proposed regulation, and each violation would be subject to not more than USD 1,000, with each day on which a violation continues being considered a separate offense. Also proposed are "prior disclosure" provisions in which disclosure of a violation to the FTZB prior to its discovery would result in the potential total fine being reduced to USD 1,000.

These provisions are also controversial. It is unclear where enforcement efforts of the FTZB and Customs and Border Protection (which has the oversight responsibility for approved FTZs) may overlap. Moreover, the proposed regulations do not address the parameters for penalties resulting from particular violations, other than noting the statutory limit, and providing generic mitigation factors. As the FTZB has no prior recent history of assessing any penalties, these provisions are also expected to generate substantial comment.

Comments to the FTZB proposed regulations are due by 26 May 2011. The FTZB has indicated that it will review all submitted comments and issue a revised proposed regulations notice.

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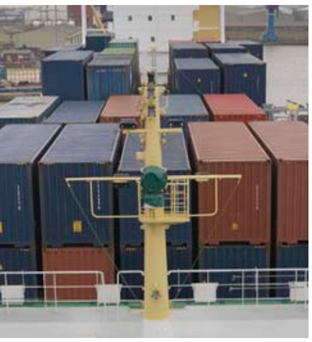
Foreign Trade Zones Board issues decisions in three controversial cases



The US FTZB issued final decisions is three long-standing and controversial cases on 20 December 2010. In each of these cases, the FTZB took the unusual step of ordering a public hearing, and then took the unprecedented step of issuing a preliminary recommendation for further public comment before making a final decision. In two related cases involving silicon, the FTZB followed its preliminary recommendation, and established what many believe to be a new standard for cases involving imports subject to antidumping duties. In the third case, involving steel production, the FTZB reversed its preliminary recommendation and granted the importer's request.

The silicon cases

Applications were filed on behalf of two importers of silicon in May 2009, REC Silicon and Dow Corning. In both instances, the imported silicon was subject to antidumping duties. Current FTZB regulations require that any imports into an FTZ of items subject to an antidumping duty must be placed in privileged foreign status, meaning that they maintain their identity regardless of further processing. As a result, duties may be deferred, but not avoided, for items consumed domestically. Items that are exported are generally free of duty. The regulations also provide that FTZ procedures shall not be used to circumvent antidumping orders, and give the FTZB authority to restrict FTZ operations to protect the public interest.

As noted above, after public hearings on both cases, the FTZB provided notice of a preliminary recommendation restricting the admission of any imported silicon subject to an antidumping order, even if the silicon was to be used for producing products for export. While the action of the FTZB was allowed under the current regulations, it marks a change in practice. As noted in the companion article about the newly proposed FTZB regulations, this change has been incorporated into the new proposal.

Steel production

A case of first impression involving the production of steel in a US FTZ resulted from the application of ThyssenKrupp Steel and Stainless USA to obtain FTZ status for its new plant in Alabama filed in October 2008. The application brought objection from some domestic competitors, and from unions active at the competitor's sites. Unlike the silicon cases, the objections did not come from suppliers of domestic materials, but instead from other producers of steel. In fact, it was uncontroverted that many of the materials which ThyssenKrupp anticipated importing were not available in sufficient quantities from domestic sources alone. Following a public hearing, the FTZB issued a preliminary recommendation that the subzone benefits be limited to export only, citing concern that other domestic steel producers may not be able to access the FTZ program without undue cost and complication. That position was reversed in the final Board Order issued on 20 December, which removed the export-only restriction.

For additional information, contact Bill Methenitis, *Dallas*, Ernst & Young LLP (United States) at william.methenitis@ey.com (Tel. +1-214-969-8585). Ernst & Young, LLP advised ThyssenKrupp Steel and Stainless USA over the course of its application and proceedings.

Japan

2011 Japan tax reform proposal brings key changes to customs programs and procedures

Japan's 2011 tax reform proposal, released on 16 December 2010, includes key changes to certain customs programs and procedures that may impact the amount of customs duties paid by current importers in Japan. The proposed tax reforms will be discussed by the Parliament (Diet) and are expected to be passed before the end of March 2011, with most of the changes effective from 1 April 2011. Please note that the Diet may modify or amend certain items.

The proposal includes significant changes in the following areas:

1. Revision of the GSP program
2. Reduction of Most Favored Nation (MFN) rates for certain items
3. Extension of customs assessment period
4. Revision of export procedures and the Authorized Economic Operator (AEO) program

1. Revision of GSP program

GSP is a trade program that aims to assist the economic development of developing countries by providing preferential access to Japanese markets through the application of reduced duty rates on certain products from specified developing countries. As the current GSP program is set to expire on 31 March 2011, the reform proposal seeks a ten-year extension of the GSP program with the following amendments:

Removal of ceilings for industrial products

Under the current GSP program, ceilings (import volume limits) are stipulated for 1,182 industrial products. When imports from GSP beneficiaries exceed the ceiling, the preferential duty rates are suspended until the end of the year, and the higher MFN rates are applied for the rest of the year.

The reform proposal seeks to remove this ceiling on all industrial items. However, it also proposes to revise the GSP rates on such items. As a result, there will no longer be any limitations on the number of imports that can benefit from the GSP rates; however, the GSP rates will increase for a number of products. For example, Sorbitol will increase from 3.4% to 10.2% and aluminium foil will increase from 0% to 6%.

Graduation of certain beneficiary countries from the GSP program

Oman, Republic of Trinidad and Tobago, and Barbados were classified as high income economies in World Bank statistics for three consecutive years. As a result, these countries will no longer be GSP beneficiaries from 1 April 2011.

Exclusion of certain products originating in China, Thailand and Brazil

The reform proposal seeks to revise the current formula for calculating the exclusion from the GSP program of certain products from some beneficiaries. The application of the new formula will result in the exclusion of approximately 100 products of Chinese origin, including agricultural and fishery products, gloves, curtains, umbrellas and toys. Certain products from Thailand and Brazil will also be excluded.

Revision of product coverage

Under the reform proposal, certain goods shall be completely excluded from GSP coverage (from all beneficiary countries) from 1 April 2011. The affected goods include products of leather, footwear, jewelry (including imitation jewelry), neckties and ferro-alloys, among others. For a complete list, see the following link to Addendum 5-4 of the 2011 tax reform proposal (Japanese only): http://www.cao.go.jp/zei-cho/news/2010/__icsFiles/afieldfile/2010/12/25/221216taikou.pdf.

2. Reduction of MFN rates for certain items

Under the reform proposal, MFN rates (i.e., duty rates applicable to WTO member countries) for certain products shall be reduced from 1 April 2011. The affected goods include barium nitrate, lingerie, co-axial cable, electric conductors and embroidery, among others. For a complete list, see the following link to Addendum 5-5 of the 2011 tax reform proposal (Japanese only): http://www.cao.go.jp/zei-cho/news/2010/__icsFiles/afieldfile/2010/12/25/221216taikou.pdf.

3. Extension of customs assessment period

The reform proposal will extend the period during which the customs authorities may make an assessment and collect underpayments of customs duties and import taxes from three to five years. Additionally, the period during which the taxpayer can request a correction would also increase to five years, from the current one-year period.

While the assessment period is set to increase to five years, the reform proposal also seeks to increase the transparency of assessments made by requiring the customs authorities to provide reasons for the assessments made. The proposal also stipulates that post-entry audit procedures should be legislated.

4. Revisions of export procedures and the AEO program

Under the reform proposal, exporters shall be able to make export declarations before the goods are entered into a bonded area, allowing for a more efficient and speedy export declaration process. Furthermore, under the AEO program, authorized customs brokers and authorized manufacturers shall be able to receive export permits without entering the goods into a bonded area. Currently, this is allowed for authorized exporters only. These revisions will become effective from 1 October 2011.

Implications for business

Japan's 2011 tax reform proposal brings key changes to certain customs programs and procedures. These changes have the potential to negatively impact some importers while other traders may identify new opportunities.

For example, revisions to the GSP program may result in higher customs duty costs for your business, depending upon the origin and tariff classification of your imported goods. Various customs planning strategies may help alleviate the impact.

On the export side, the revisions provide new opportunities to improve supply chain speed. In this respect, your company should look closely at the revisions to the export procedures and the growing advantages of the AEO program.

From a customs compliance standpoint, the increase in the assessment period to five years may increase your company's exposure to higher duty assessments during a post-entry audit. Given the potential risk, your company may wish to review existing import declaration procedures and if necessary, file for revised declarations to avoid any penalties.

Overall, companies should act proactively to understand the implications of the reform proposal on their business, and be prepared to mitigate any potential negative impact as well as take advantage of new opportunities.

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New Zealand

New Zealand proposes changes to the de minimis threshold — why it matters to business

The New Zealand Customs Service (Customs) is considering various proposals to change the de minimis threshold applied to imported goods for Goods and Services Tax (GST) and tariff duty (i.e., customs duty) relief purposes. The outcome matters to business, particularly with the growth of global electronic commerce (e-commerce).

Background

The de minimis threshold for customs purposes is generally set at a level that finds a balance between the cost of collecting taxes on imported goods and the amount of tax that would be due. While many countries apply a de minimis threshold based on value, New Zealand's threshold is currently based on the amount of duty. This determination is based on a variety of factors, which has led to confusion as to how the de minimis applies.

Regulation 70 of the Customs and Excise Regulations (1996) provides that the amount of duty below which the duty need not be collected on any imported goods is NZD 60. The definition of duty includes tariff duty, GST and other taxes and levies; however, only tariff duty and GST impact the de minimis.

Another factor is that each tax is determined based on a different valuation approach. Tariff duty is based on the customs value of the goods; whereas GST is levied on the total of the customs value, duty, international freight and insurance costs.

Additionally, even though the de minimis amount is based on the combined GST and tariff duty amount, in practice, some goods may not actually be subject to both tariff duty and GST. For instance, tariff duty rates have declined over the years and now many goods are duty-free, particularly through New Zealand's various preferential trade agreements. Additionally, GST might never be collected if the goods are not sold in New Zealand as part of a taxable supply by a GST-registered person, as can be the case when a New Zealand consumer purchases a good directly from a foreign firm via the internet. Unlike some other countries, New Zealand does not have specific rules or thresholds for distance selling.

Proposed changes

Customs recently conducted a review to consider changing the de minimis threshold in an effort to simplify procedures and increase the effectiveness of duty collection. The results of the review were published in Customs' Issue Paper "Review of De Minimis."

As provided in the Issue Paper, Customs is proposing to replace the use of the GST and tariff duty calculation with the consignment value of the goods. This use of the consignment value is more in line with many other countries and takes away much of the complexity and compliance costs associated with the current calculation. The debate centers around the threshold value amounts under consideration, which are NZD 400, NZD 650 and NZD 1,000.

In the Issue Paper, Customs favors a maximum consignment value of NZD 400 to qualify as de minimis, which best equates the current NZD 60 level of GST and tariff duty combined. Customs estimates that this amount would allow a further 22,000 GST and duty-free imports per annum under the de minimis rules. On the other hand, a de minimis level of NZD 400 is low compared to most of New Zealand's major trading partners. Nevertheless, the initial view of the customs authorities is that the NZD 400 limit would be an appropriate level.

In discussing increasing the de minimis level to a consignment value of NZD 650 or NZD 1,000, Customs concludes in the Issue Paper that the revenue foregone from such a change would outweigh the compliance and administration costs of collecting it and thus, would not justify such an increase.

Implications for business

With the growth of e-commerce in a global marketplace, changes to the de minimis threshold do have implications for business. Domestic retailers are facing competition from overseas firms selling direct to New Zealand consumers via the internet. Accordingly, domestic retailers fear a higher de minimis level would provide a greater propensity for consumers to purchase from overseas suppliers. On the other hand, other businesses, such as express courier services, would benefit from a higher de minimis level with lower administration and compliance costs.

Although Customs' Issue Paper clearly stated a preference for the threshold value of NZD 400, the final outcome is not certain. The public comment period ended on 12 February 2010. Now Customs is considering the submissions and preparing its report to the government with its final recommendations for change. Accordingly, all interested parties are actively awaiting the final outcome.

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European Union

European export controls: The changes to encryption export controls and their implementation by European member states

The trade community is applauding recent trade facilitating changes to the Wassenaar Arrangement's global framework of encryption export controls. However, the changes have not completely trickled down to the national level, which may be creating confusion and compliance concerns for affected exporters, particularly in the European Union.

Changes to encryption export controls

In December 2009, the Experts Group of the Wassenaar Arrangement on Export Controls made several changes to the 2009 list of dual-use goods and technologies. These changes, having been agreed by the delegates of the participating states, were then required to be incorporated into national legislation.

Encryption export controls were a specific focus of the amendments made in 2009. Amendments included a new 'Note 4' being added to Category 5, Part 2 of the Wassenaar dual-use control list, which is intended to exclude goods from control when the item uses cryptography, of the level specified in that Category, but where the item's primary function is not related to "information security;" computing; networking; or sending, receiving or storing information. These changes were intended to exclude goods such as robotics, household appliances, fire alarm systems, gaming products and inventory management software and hardware, which use encryption as an ancillary, not primary, function.

During the latter part of 2010, the Wassenaar Arrangement changes began to be implemented across a number of the participating states. In June, the United States published its new encryption rule amending the Export Administration Regulations; Hong Kong amended its strategic commodities legislation the same month; and the Singapore government updated its Strategic Goods (Control) Order two months before, in April 2010.

A notable exception to countries that hastily amended their legislation is the member states of the European Union, whose dual-use export controls are governed by the EU Dual Use Regulation (428/2009). The European Commission has yet to amend the Regulation and has only just completed a lengthy process of issuing a recast Regulation in 2009 (which incorporated all amendments made to the Regulation since 2000). Considering the length of time required for consultation and promulgation of new legislation, the Commission will understandably be slow in incorporating the agreed 2009 Wassenaar changes.

Where does that leave EU exporters of 'ancillary' encryption goods? On a plain reading of the governing legislation, companies with operations in a number of countries — say, the United States, Hong Kong and the Netherlands — would find their goods de-controlled by the amendments made by the United States and Hong Kong, but would remain controlled for export from the European Union based upon the current, un-amended EU dual-use control list.

Implementation in the European member states

The EU Regulation gives responsibility for licensing to the national authorities and in deciding whether or not to grant an authorization, the relevant authorities must take into account a number of considerations, including their obligations and commitments as members of international non-proliferation regimes and other relevant export control arrangements. The individual EU member states are participating states under the Wassenaar Arrangement and accordingly have agreed to the 2009 amendments.

Consistent with both the Commission's intention to include 'Note 4' in a revision of the EU dual-use list and the member states' obligations under the Wassenaar Arrangement, national export control authorities may therefore take into account the 'Note 4' rationale in their national licensing policy, either during consideration of an application or through creation of a new national licenses such as a 'national general export authorization.' As a result, EU 'ancillary' encryption exporters may not in reality be disadvantaged by the absence of changes to the Regulation. Instead, however, they may be subject to different authorization procedures depending upon which member state they are exporting from.

Amongst EU member states, the United Kingdom (UK) is one of the most prolific creators of 'national general export authorizations,' licenses defined by national law allowing export of goods to destinations specified in the authorization. In the UK, these are called Open General Licenses (OGLs) and in order to incorporate the Wassenaar encryption amendments, the UK created a new OGL to authorize the export of goods that will be de-controlled by the operation of 'Note 4.' Use of the authorization is subject to certain conditions, registration and record-keeping requirements, but knowing this OGL is in place and having registered to use it, exporters are not required to make any form of application. Accordingly, there will be no delay before exporters are able to ship their 'Note 4' qualifying goods to specified destinations.

This position is, however, contrasted to that of the relevant authorities in the Republic of Ireland, Belgium and the Netherlands, where no national general authorization exists to cover this situation and, therefore, a license application (or a prior request for a classification decision) is still required. During the decision-making process, the relevant authority will then exercise its licensing discretion and should take into account that the goods in question had technical characteristics of the kind that will remove them from control under 'Note 4.' It is within the competence of the national authority what action they take as a result, but it is our understanding that, in Ireland and Belgium, the applicant would then be informed that no license would be required for export of the goods to specified destinations. In the Netherlands, however, the position appears to be that exporters will be granted a license, but informed that the goods will be decontrolled once the Regulation is amended. In Ireland and Belgium, while the goods would effectively be treated as though they were de-controlled, the first export would, however, be delayed while the exporter was required to make an application, wait for it to be processed and a formal response issued so that their goods would be treated as not requiring a license. In the Netherlands, exports will also be delayed as 'Note 4' qualifying goods continue to require licenses until the goods are officially de-controlled through amendment of the Regulation.

While the above are examples of how certain national authorities are reacting to the current situation, the practice may vary further across other member states. It is therefore understandable that EU exporters of 'Note 4' qualifying goods may encounter some confusion in respect to how to manage exports of these goods from multiple countries. For example, exporters of 'Note 4' qualifying goods who have operations both within and outside the European Union, may be faced with further confusion as a result of the differing treatment of the same goods from their operations around the world. This may result in an increased risk of non-compliance especially if license determination is being managed centrally by teams with primary expertise in a country for which the goods have already been de-controlled (e.g., the United States) and who may therefore incorrectly believe that the European member states, having agreed to the de-control under Wassenaar, have also made the same change in practice. In reality, however, the situation is quite different as demonstrated by the examples of differing approaches in the UK, Ireland, Belgium and the Netherlands.

How EU exporters can address the implementation transition period

The different application of the incorporation of the 'Note 4' changes is a prime example of why exporters need to both verify the position in current, applicable legislation and also ensure they are aware of the required licensing practice in the relevant country in order to fully ensure their compliance.

Companies that believe their goods may be capable of de-control under the recent Wassenaar Arrangement amendments and have operations within the European Union should first research whether a national general export authorization exists, specifically to cover the 'Note 4' decontrol from their country of export (or their European country of establishment, if different). If no national general export authorization applies and a process exists for submitting an application for a classification determination, this could be considered and put into process, prior to the need to export. Based upon the examples mentioned above, the outcome of this classification determination would notify the exporter clearly whether goods would be treated as de-controlled or whether a license is still required for export from that specific member state. If a license is required then a licensing strategy should be considered in advance to reduce any disproportionate impact created until the 2009 changes are incorporated into the EU dual-use list. Such a strategy could include:

- Application for an individual license, allowing export of a specific quantity of goods to the same end user, which could be used to facilitate multiple exports until the quantity is exhausted, or
- Application for a global license, permitting multiple exports of the goods to multiple destinations and/or multiple end users.

In many EU member states, pre-requisites are attached to acquisition of global licenses, such as a compliance history of exporting the same goods under individual licenses or global licenses only being permitted for certain types of goods. It would be reasonable, however, to believe that the relevant licensing authority would be flexible in granting a global license in respect to goods that will be formally decontrolled in the near future.

Exporters with a corporate establishment in one member state and branch operations in other countries within the European Union should also take note that licenses may be obtained from their member state of establishment and then used to facilitate exports of those goods from branch operations in another member state. In order to promote certainty and to eradicate shipping delays encountered as a result of potential treatment of the 'Note 4' qualifying goods as still licensable, a global license could be applied for and, if it is stated in the application that the exports may take place from other country locations, then the global license may facilitate exports from all the exporter's operations within the European Union, subject to consultation and approval by the other relevant authorities.

In conclusion, correct classification and license determination in line with regulation and national practice remains paramount for exporters in order to minimize the risk of non-compliance across their multi-jurisdictional operations. The differing licensing treatment applied by the member states in the above examples details this potential risk. It is essential that exporters be aware of possible national differences and utilize the processes in place to test these in advance. By employing a forward-thinking licensing strategy, exporters can both proactively manage their compliance and also avoid commercial repercussions such as shipping delays and failure against contractual commitments.

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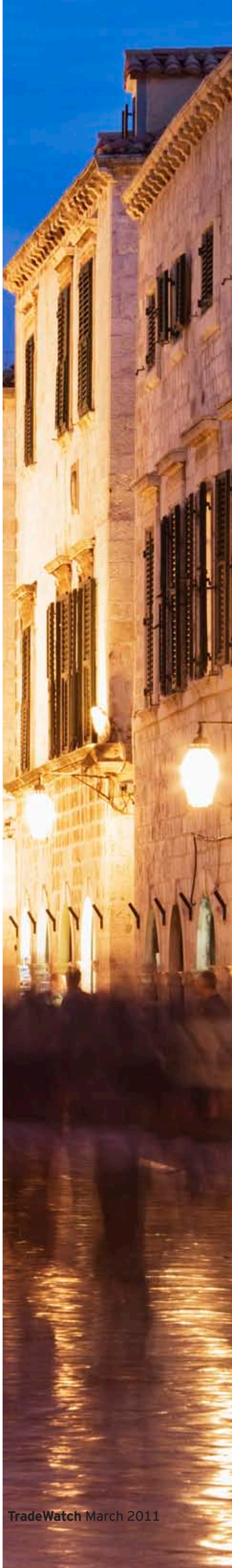

The customs duty drama continues for certain LCD monitor importers

EU importers recently claimed victory with the 2010 WTO ruling, which held that the European Union's imposition of customs duties on certain information technology (IT) products, including liquid crystal display (LCD) monitors, violates the Information Technology Agreement (ITA). In reality, however, certain types of LCD monitors imported into the European Union have been subject to "temporary" duty suspensions since 2006 pursuant to various Council Regulations — until now.

Council Regulation 179/2009 expired, along with the duty suspension, on 31 December 2010. As a result, from 1 January 2011, some of the LCD monitors previously subject to duty suspension regulations are now subject to 14% duty. Many importers are shaking their heads to understand how affected LCD monitors can now be subject to 14% duty, particularly considering the European Union's acceptance of the WTO ITA ruling.

Background

Since 1996, customs duty on a wide range of IT products, including computers, peripherals (e.g., computer monitors) and telecommunication products, has been exempted from customs duties by the signatories of the ITA. Due to advanced technology innovation, many of these IT products now incorporate newer technologies and additional functions. For example, LCD monitors can now also serve as television screens.

Historically, the European Union has taken the position that the functionality added to some of these products make them consumer goods and thus, not subject to the ITA. As a result, certain dual-use LCD monitors were classified in the European Union as video monitors, subject to 14% customs duty upon importation, rather than as duty-free computer monitors. However, due to political pressure, the European Council acted to suspend customs duty on certain types of LCD monitors, which were claimed by industry as output units of computers.

Council Regulation 179/2009 (dated 5 March 2009), which applied the duty suspension to LCD monitors classified under 8528.59.90.40 and 8528.59.10.10, expired on 31 December 2010. To-date, there has been no new EU regulation to further extend the suspension, and the new 2011 EU Combined Nomenclature (CN), which came into effect on 1 January 2011, also does not refer to any duty suspension. We note that under the 2011 CN, the tariff code for color LCD monitors has changed to 8528.59.40.90. These LCD monitors are currently being assessed 14% duty upon importation into the EU.

What to expect

It is expected that the European Commission (EC) will extend the duty suspension for the LCD monitors classified under CN 8528.59.40.90 and 8528.59.10.10 for another six months with retroactive effect from 1 January 2011. This shorter time period, compared to the previous Council Regulations, is likely due to other initiatives under way to remove the customs duty on affected IT products pursuant to the WTO ITA ruling against the European Union by the 30 June 2011 deadline.

Until the anticipated European Council regulation comes into effect (expected in April 2011), importers must address the cash flow implications of the 14% customs duty assessed on the import of the affected LCD monitors. Unfortunately, the customs authorities will not waive the duty based on the expectation that the suspension will be formally extended in the near future with retrospective effect. The good news is that once the retrospective regulation comes into effect, the importer can file a refund of any customs duty paid on affected imports pursuant to procedures established in the Community Customs Code.

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Single Authorization for Simplified Procedures in Hungary and the Netherlands: practical aspects of an EU-wide initiative

The Single Authorization for Simplified Procedures (SASP) is a relatively new opportunity for companies in the EU and especially for AEOs that file import or export declarations in more than one EU member state to centralize customs declaration processing in their country of residence, regardless of where in the European Union the goods are located at the time of release. This program has the potential to grant significant trade facilitating benefits to approved companies. However, the program is still evolving and there continues to be practical aspects of the EU-wide initiative that should be considered.

SASP overview

The SASP license aims to decrease the administrative burden of the economic operator, which is able to rely on customs formalities established in its 'native' member state, subject to the consent of the cooperating other member state(s). Accordingly, obtaining the SASP license requires approval from and extensive cooperation between the customs authorities of the designated member states.

Applicants must meet certain criteria linked, but not limited to the standards for AEO Customs simplifications status. For this reason, AEO status is beneficial, although not mandatory.

Specific benefits attached to the SASP license encompass the submission of the customs declaration in the license-granting member state, subject to the relevant customs rules and interpretation thereof by that member state, such as representation, valuation, tariff classification, data requirements, and timing. Customs duty accounting and compliance is handled by one customs administration in the national language of the company. In addition to reduced administrative costs, the company can also better manage customs planning and compliance.

For instance, the company can centralize its customs function in the license-granting member state. Additionally, the company can focus on the application of the rules by its member state, rather than dealing with the nuances in interpretation (e.g., customs valuation, tariff classification) by other member states as well.

The legal framework of the SASP license has been laid down at an EU-wide level by the Community Customs Code[2] and its Implementing Provisions[3], whereas member states have the right to tailor the rules in their national legislation within this framework. As a result, there may be differences in the rules from each member state, which should be considered to facilitate the smooth and efficient SASP implementation.

Practical aspects of the EU-wide initiative

To illustrate some practical aspects of an SASP arrangement, we look to a recent example involving an AEO-certified economic operator based in the Netherlands that brings goods into the territory of the EU under bond for transport between bonded warehouse facilities in the Netherlands and Hungary until placed in free circulation in the EU or re-exported to third countries, as business needs require. Under the SASP license, the economic operator can declare goods for customs clearance and account for customs duty at their local Dutch office, even though the goods may actually be located in another member state of the European Union (in our case, Hungary) at the time of the customs clearance. While seeking the approvals and cooperation with the customs authorities in the Netherlands and Hungary, the company soon identified some practical aspects of this arrangement that add some complexity to the simplified process.

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[2]Council Regulation No. 2913/92 (EEC) on the establishment of the Community Customs Code

[3]Commission Regulation No. 2454/93 (EEC) on the Provisions Implementing the Community Customs Code

Inconsistent AEO benefits

The first item discovered related to the recognition of the AEO certificate and the acknowledgement of the underlying benefits by the designated member states. In the Netherlands, being an AEO-certified operator enables the company to be relieved from the provision of certain customs securities/guarantees. Nevertheless, the Hungarian legislation does not explicitly recognize such relief. As a result, despite being an AEO, any transit procedure lodged in Hungary with respect to the goods being re-exported from the bonded warehouse is subject to the regular rules on guarantees.

Another aspect to consider is the security required for the goods under bond. Being an AEO-certified operator, the Dutch rules provide relief from securing certain customs, VAT and other local taxes that may be due in the Netherlands. However, the Hungarian authorities require the operator to guarantee the full amount of customs duties payable on the bonded goods in the Hungarian warehouse.

VAT considerations

Under SASP, unlike customs duty, VAT is due upon importation and is settled according to the rules of the (other) member state, where the goods are physically located at the time of importation.

The Hungarian rules provide for the possibility of VAT deferment, i.e., the self-assessment of VAT on importation with the possession of a specific license. The key benefit of the VAT deferment license is to relieve the economic operator from VAT financing, as any VAT should be declared through the local VAT return. This license should, generally, have the positive impact on the calculation of the customs security for goods both under bonded warehousing and under transit, leading to the relief from securing any VAT on the transaction. However, the decision to include VAT in the amount of the guarantee brings other interpretative decisions to light.

The Hungarian rules acknowledged the relief from securing the VAT on goods under bonded warehousing; nevertheless, the rules did not explicitly do so for goods under transit, resulting in a different amount of customs security/warranty for the same goods, depending on the customs procedure they are under. (Note, both bonded warehousing and transit, when carried out properly, should not impact the non-community status of the goods.)

Statistical reporting

Due to the nature of the SASP license, customs declarations relating to release into free circulation are filed in the license-granting state (i.e., the Netherlands in our example), whereas the goods are physically located in Hungary. Therefore, for economic statistical purposes, the two authorities must find a way to exchange the relevant data enabling Hungary to draw up accurate statistical records. Such data exchange is done by way of an additional reporting requirement placed upon the economic operator.

Experience level of the customs authorities with SASP

Last, but not least, one must also take into account the differences in the way the participating customs authorities tackle issues. In a Hungarian environment, the customs authorities tend to be more bureaucratic and stick to the letter of the law rather than the principles behind it. Hence, applicant should bear this in mind when addressing queries to the authorities.

Implications for EU businesses

SASP is a key customs facilitation initiative in the EU, which will be laid out in a specific Article in the upcoming Modernised Customs Code. The program has the potential to offer significant advantages and is a customs strategy that EU companies that import/export in multiple member states should consider.

We have highlighted some of the practical aspects of an SASP arrangement that should be considered prior to application. While such aspects do not necessarily outweigh the advantages of SASP, future applicants should be prepared for dialogues with the customs authorities to identify and address these kinds of issues.

The good news is that much of the pioneer work has been done. Both the Dutch and Hungarian authorities have had the opportunity to experience each other's working methodology and establish a balanced and cooperative working relationship. This, supported by the fruitful cooperation by Ernst & Young Advisory Ltd. (Hungary) and Ernst & Young Belastingadviseurs LLP (the Netherlands), led to the result of the SASP license being issued within five months. The remarkably short period within which the cross-border license has been granted may indeed be considered an achievement, given the above constraints.

As more companies begin to operate under a SASP license and the customs authorities of the member states gain more and more experience with SASP dealings, many of these issues will be resolved. Therefore, an increasing number of companies having cross-border operations should be able to benefit from the EU-wide initiative.

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Turkey

The new post-clearance customs audit approach

After establishing a Customs Union with the EU, Turkey enacted Customs Law No. 4458 (1999) to align its customs rules with EU legislation. Since then, the customs environment in Turkey has been undergoing significant and sometimes radical change.

With respect to customs controls, the policy of 100% border inspection has been replaced by the customs risk management model, whereby the customs authorities apply standardized techniques to identify shipments that present a risk. Border inspections are thus more focused on higher risk shipments while low risk shipments gain more expeditious clearance, subject to post-clearance controls. This model promotes trade facilitation for low risk importers and exporters so that customs resources can be better allocated. To achieve this, Turkey has implemented the post-clearance control system.

Post-clearance control system

Article 73 of Customs Law No. 4458 provides, generally, that the customs administrations may, after releasing the goods, verify the accuracy of the import or export transaction by inspecting the related commercial documents and data. Such inspections may be carried out at the premises of the declarant. The implementing "Regulation on Post-clearance Control and Control of Risky Transactions" was published in the Official Gazette on 27 October 2008.

Basically, customs assessment of an importer or exporter's compliance with the customs and foreign trade laws has moved from pre-clearance customs inspections at the border to post-clearance customs audits at the company's facilities. The audits are conducted in a planned and systematic way based on risk analysis processes and techniques.

Customs audits — what to expect

The customs authorities have quickly adapted to the new post-clearance control approach and are rapidly expanding their audit coverage. During the years 2008, 2009 and 2010, the number of companies audited grew to 200, 250 and 450, respectively.

The companies subject to an audit are selected annually by the customs authorities. Some of the companies are targeted based on risk criteria, while others are selected at random. Therefore, every company performing customs transactions is at risk for audit within the framework of the post-clearance control plan.

The audit process is generally handled as follows: First, the company receives formal notice from the central inspector at least 15 days prior to the commencement of the audit. The process is well-documented with "commencement minutes" issued jointly by the customs authorities and the company at the initiation of the audit. The customs authorities conduct their examination, verifying the customs transaction information with the company's commercial documents, accounting records, financial statements and other information, as required. After the examination is conducted, the central inspector holds a meeting with the company to present the results of the audit, including disputed issues, legal evaluation and any additional customs liabilities resulting from the identified issues. Following the audit, the central inspector issues a report to the Risk Management and Strategic Evaluation Unit, which provides the audit results and assigns a risk category (i.e., low, medium or high) to the company.

In these inspections, the customs authorities have focused primarily on tariff classification, country of origin and customs valuation determinations. With respect to customs valuation, primary areas of examination include:

- Royalty and license payments
- Commission payments
- Expenses, such as demurrage, shipment-release
- Freight and insurance payments on delivery method basis
- Boxes and shipments (cargo) shipped via fast shipment
- Secondary compensating products under the inward processing regime

Managing customs compliance

The Regulation on Post-clearance Control and Control of Risky Transactions has introduced a new era for customs controls. For importers and exporters, this means that customs compliance responsibilities do not end when the goods are cleared at the border; rather, customs compliance is assessed during a post-clearance customs audit.

The company is responsible for making accurate customs declarations, which requires knowledge and understanding of the customs and foreign trade laws and how they apply to the customs transaction. Further, the information declared must be supported by company data, such as commercial documentation, accounting records and financial statements, among other documentation. Non-compliance identified in the course of a post-clearance customs audit can result in costly penalties and damage the company's risk status. Low risk companies enjoy less customs scrutiny while higher risk companies may be subject to additional border inspections resulting in supply chain delays.

More than ever, customs compliance requires a proactive approach. It is important that companies focus resources and efforts to identify and define their risk areas, to develop appropriate internal controls for managing these risks on a daily basis, and to create effective self-monitoring techniques once the appropriate controls are implemented.

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India

Customs self assessments coming to India

The Indian Finance Minister presented the Union Budget for 2011-12 on 28 February 2011, which included a variety of customs-related changes. One significant change, which importers and exporters will need to prepare for, is the introduction of customs self assessments.

The existing customs clearance procedures involve the assessment by the customs authorities of every bill of entry or shipping bill at the border. This procedure requires significant customs resources and commonly results in border delays for importers and exporters.

Under self assessment procedures, importers and exporters will take on the responsibility for accurately assessing the amount of duty liabilities, which requires a determination of the proper customs value, country of origin and tariff classification, among other elements. The customs authorities may conduct a customs audit to verify the customs transactions at a later stage, post-importation.

The introduction of customs self assessments will be effective upon the enactment of the 2011 Finance Bill. The regulations for audit procedures will be prescribed thereafter.

The policy of self assessment is consistent with the customs risk management model endorsed by the World Customs Organization. Pursuant to this model, the customs authorities establish standardized techniques to identify shipments that represent a risk and subject those shipments to more scrutiny while low risk shipments enjoy minimal scrutiny upon customs clearance. Thus, companies that present a low risk of non-compliance with the customs laws benefit from less customs intervention and fewer border delays. The customs audit is an important tool for the customs authorities to assess the importer or exporter's compliance.

Self assessments represent a significant change for import and export operations in India that requires a proactive approach to customs compliance. Companies need to prepare for these changes, including the implementation of procedures and internal controls to ensure that accurate data is declared to the customs authorities.

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East African Community

New duty collection and revenue-sharing scheme in the East African Community

The East African Community (EAC), consisting of Burundi, Kenya, Rwanda, Uganda and Tanzania, recently launched a pilot program for the implementation of the new duty collection and revenue-sharing scheme, a key element in the creation of a single customs territory. The new scheme has the potential to change the way trade is conducted with the EAC and should reduce the cost of doing business in the region for traders. The revenue authorities expect that the scheme will contribute to reducing tax evasion through smuggling goods in transit between the ports of entry and the final destination. However, the successful implementation requires a look at the scheme's inherent challenges and business implications.

Duty collection and revenue-sharing scheme

As a background, the EAC Customs Union commenced in January 2005 and is working toward the next milestone in its plan for regional integration and cooperation with the full implementation of the Customs Common Market protocol. One of the key discussions has been the need for an agreement by partner states on a duty collection and revenue-sharing scheme, considering that Burundi, Rwanda and Uganda are landlocked, and thus, would lose considerable revenue from import tariffs under a customs union.

Currently, goods encounter repeated customs procedures at most of the countries' border control points, which create supply chain delays and additional transport costs due to bond and other administrative requirements. To address some of the above issues, the partner states have agreed to a scheme whereby duties and taxes collected at the port of entry will serve as the bond/guarantee to the transit countries during transit while also serving as the duties payable to the country of destination.

An electronic tracking system, developed by TradeMark East Africa, an organization established to support EAC regional trade and economic integration, will account for the duty collection and revenue-sharing associated with the movements of the goods. Instead of customs procedures at the border control points, a message is simply relayed from one scheme manager to another indicating that the goods are still intact with the duties and taxes collected at the port of entry serving as guarantee to countries of destination. This scheme thus provides the required security for the revenue authorities, but removes the burden of bond costs from the trader.

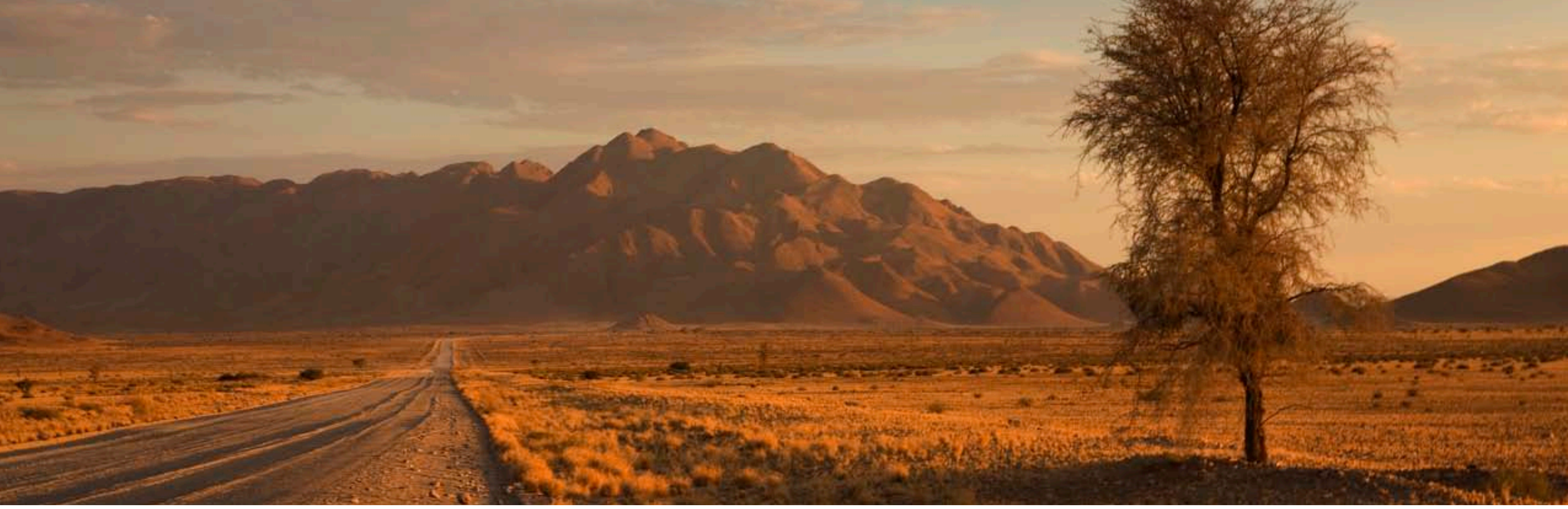
In January 2011, the EAC entered into a partnership with various commercial banks to participate in a pilot program to implement the electronic system of duty collection and revenue-sharing. Initially, this system will be applied by the Tanzania revenue authority at the port of Dar Es Salaam, handling imports to landlocked cities of Kigali and Bujumbura, before being replicated at the Mombasa Port.

Challenges and business implications

The implementation of the duty collection and revenue-sharing scheme will change the way trade is conducted with the EAC. With the changes come challenges and implications for business.

1. Operation of bonds for transit goods

The proposed system will essentially render national bond systems as no longer relevant, considering that there is no longer a need for a guarantee for duty not yet paid, as the duty is in fact already paid upfront at the port of entry. This may be an advantage to taxpayers who have been incurring costs for bonds in each of the countries of transit en route to their destination. However, bond operators and insurance companies will suffer from the loss of business.



2. From tax collection to post-importation audits

The only ports at which taxes will be payable are Mombasa in Kenya and Dar es Salaam in Tanzania. Uganda, Rwanda and Burundi have no ports. The staff of the revenue authorities of Uganda, Rwanda and Burundi will no longer need to handle duty collections. Rather, the affected revenue authorities may shift their focus from facilitation at importation to post-importation audits and reconciliation of taxes received from ports of entry. Furthermore the partner states with ports will require more staff at the ports of entry to facilitate the increase of clearance activity and duty payment.

3. Use of Internal Container Depots (ICDs) and bonded warehouses

ICDs and bonded warehouses are primarily used to facilitate importers with storage of their goods before taxes have been paid. Bonded warehouses have proven to be interesting instruments for cash flow optimization and are set up to facilitate re-export of imported goods, without being exposed to any duty cost.

In a system where taxes are paid at the port of entry, ICDs and bonded warehouses in the in-land partner states will have minimal use, if any. This may lead to some loss of revenue for the latter partner states and for the operators of these businesses.

Taxpayers in Uganda, Rwanda and Burundi — the EAC countries that have no ports — will need to consider that all import duties will be paid outside their country of residence/consumption. Thus, cash flow will be affected since they will have to pay taxes earlier compared to the current system. Even though these taxpayers will have the option of using bonded warehouse facilities at the ports of entry, easy access to their goods when required and proximity to the bonded warehouses will be a challenge.

4. Revenue-sharing between the partner states

Available information regarding the operation of the system does not indicate in what proportions and how the revenue-sharing will be conducted among the partner states. For instance, it is unclear whether the taxes paid will be remitted to the country of consumption instantly by the bank. The amounts of revenue shared and the period within which the importing country will receive taxes paid will be critical for the successful implementation of the system across the EAC region.

5. Non-tariff barriers

In most of the partner states, non-tariff barriers still exist and these have been reported as top obstacles for trade within the region. These include road blocks, immigration procedures and inspections, among others. These barriers are applied to both goods for which duty has already been paid as well as goods in transit.

Conclusion

The success of duty collection at the ports of entry in the EAC will largely depend on how the above mentioned challenges will be dealt with. In theory, businesses trading with the region should benefit from lower transport costs and less supply chain delays. However, the free movement of duty-paid goods throughout the region can only be achieved if all other trade barriers are eliminated. The partner states should also carefully consider the impact on business, not only the customs clearing and bonded warehousing facilities, but manufacturing activity and industry in general, which might shift more and more toward the two ports of entry. The allocation mechanism to share the revenue equally between the five partner states is another key factor for this duty collection system to become a success and contribute to the benefit of the region as a whole.

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South Africa

Building BRICS in Africa

The recent news that South Africa has been formally invited to join a group of the world's key emerging economies, known as BRIC (Brazil, Russia, India and China) raises many questions about what building "BRICS" in Africa will mean, particularly with respect to trade opportunities.

South Africa's inclusion in "BRICS" comes after President Jacob Zuma paid diplomatic visits during the course of 2010 to all four BRIC members, focusing lobbying efforts on China. Interestingly, during that time, China overtook the United States as South Africa's biggest trading partner and it was China that extended the invitation.

The acronym BRIC was coined in 2001 by Goldman Sachs, for the benefit of their investors, to describe a grouping of large emerging economies. There is no binding agreement between them and the term is thus merely a form of classification. The countries are not formally linked in any way; their only formality is their common attendance at summits and the steps they take to improve financial co-operation and investment opportunities.

Yet, the BRIC classification has had an impact. Benefits experienced by members of BRIC in the last 10 years include a more important role in the world economy as investors shifted their focus onto them, and greater economic and diplomatic clout. This last point is important, as it can be argued that South Africa's newfound membership of BRIC is more of a political decision than an economic decision.

From a trade perspective, membership in "BRICS" does not bestow any tangible preferential trade or tariff treatment. Rather, real trade opportunities should focus on upcoming bilateral and regional trade agreements, which are already near fruition. For instance, a "South to South" preferential trade agreement between the South African Customs Union (Botswana, Lesotho, Namibia, South Africa, and Swaziland) and MERCOSUR (Brazil, Argentina, Paraguay and Uruguay) has been ratified by the SACU member states and only awaits ratification from MERCOSUR. Additionally, India and SACU are already in advanced stages of bilateral preferential trade agreement. Importantly, Russia already extends unilateral trade preferences to South Africa under its GSP program. These trade initiatives were under way prior to BRICS membership, so it remains to be seen whether membership helps push forward and expand current bilateral and regional trade opportunities out of fraternity.

Another aspect of BRICS are the implications for Africa as a whole. One of the reasons suggested for South Africa's new membership is that, as the most advanced economy in Africa, it can serve as a gateway to Africa. Considering that regional economic integration and trade reform remain a significant issue for Africa, these aspects may require more priority and attention from South Africa before effectively building "BRICS" in Africa.

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EYG no. YY2477
1103-1237867

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