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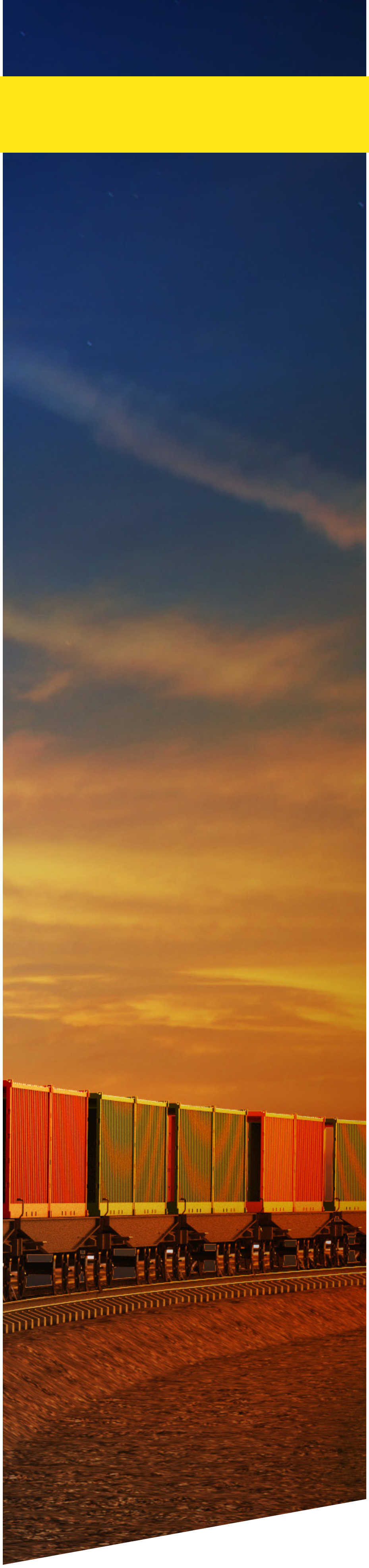

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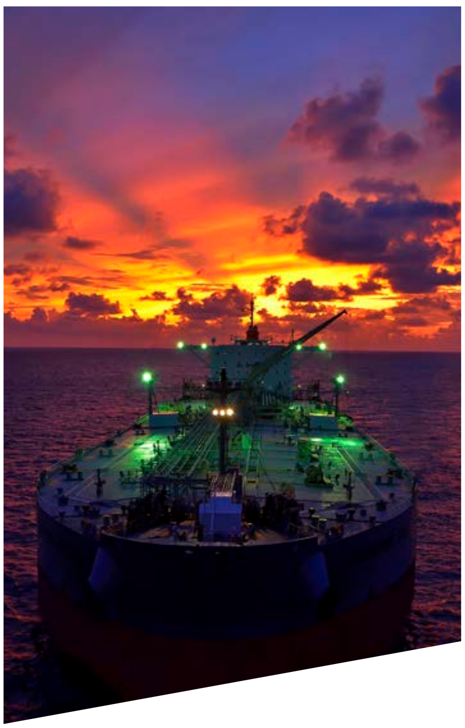
Technical Committee on Customs Valuation approves a new case study on transfer pricing



The Technical Committee on Customs Valuation (TCCV) has approved a new case study discussing the evaluation of a transfer pricing study by a customs authority. Following approval by the World Customs Organization Council, it is expected to be released as TCCV Case Study 14.2.

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

Background

While the objective of both income tax transfer pricing rules and customs related-party valuation rules is the same — arriving at arm's-length prices — the rules are different. As a result, customs authorities worldwide have struggled with whether and how documentation prepared to support income tax transfer pricing may be considered to support customs valuation.

The vast majority of importers declare import values based on the transaction value methodology, the price paid or payable for merchandise. Ease of documentation and record-keeping are often primary reasons that a business prefers using transaction value.

However, when importers purchase from related parties, special rules apply in order to use transaction value. Transaction value is an acceptable customs valuation methodology between related parties if either:

1. An examination of the circumstances of the sale indicates that the relationship between the parties did not influence the price actually paid or payable (in income tax terms, the totality of circumstances demonstrates that the parties transacted as though unrelated).

Or

2. If the transaction value of the imported merchandise approximates certain test values. Test values are not commonly used, and importers usually attempt to demonstrate the acceptability of transaction value under the circumstances of sale test.

The circumstances of sale test examines the relevant aspects of a transaction to determine that the relationship between the buyer and seller did not influence the price. In 2010, the TCCV issued Commentary 23.1 stating that a customs administration may examine a transfer pricing study in connection with its evaluation of the circumstances of sale. Last year, the TCCV approved Case Study 14.1,[1] which explains how a transfer pricing study utilizing the transactional net margin method (a method analogous to the US comparable profits method) testing the profit margin of the importer/distributor can demonstrate that the relationship between the parties did not influence the price, and, consequently, transactions priced using this approach qualify for transaction value.

The new Case Study 14.2 explains a situation in which a customs administration may conclude from a transfer pricing study that the relationship between the parties was influenced, and, consequently, the importer may not use transaction value.

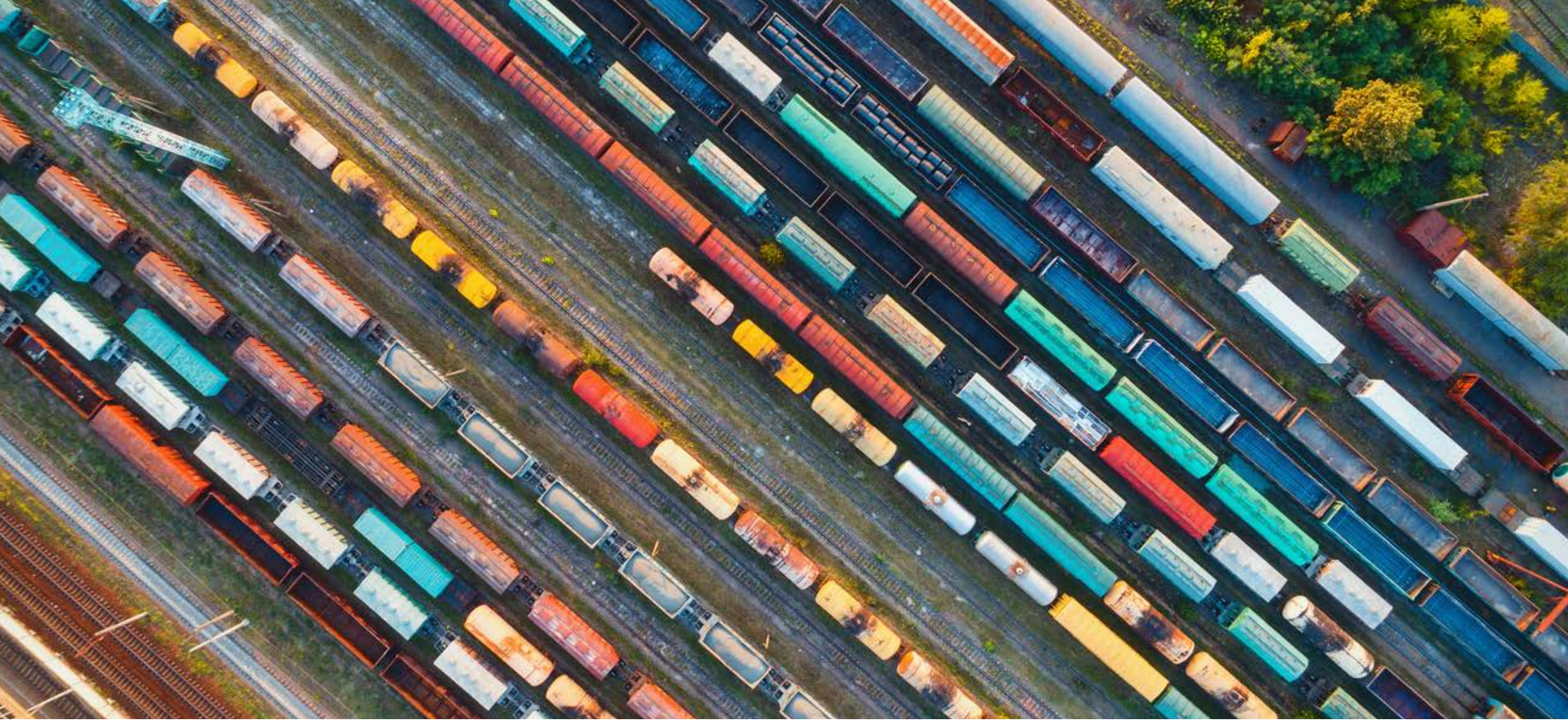
Case Study 14.2

Case Study 14.2 deals with an importer of luxury handbags purchased from a related party. Both the importer and exporter are subsidiaries of a multinational brand owner. The related-party pricing was determined in accordance with the Organisation for Economic Co-operation and Development (OECD) resale minus method, in which the profit margin of the importer is compared to the profit margin of a group of benchmarked companies that have similar functions and risks to the importer but that transact with unrelated parties. In this case, the gross margin of the importer for the year at issue was 64%. The benchmarked range of margins of the comparable companies was 35% to 46%.

Normally, when an OECD profits-based transfer pricing methodology, such as resale minus, is employed, a compensating adjustment is required if the actual profits of the taxpayer are outside of the benchmarked range. The compensating adjustment, an additional payment from the importer if the profit margin of the importer is higher than the benchmarked range or, alternatively, a credit from the exporter to the importer when the importer's profits are below the benchmarked range, will return the profit margin to a point within the range. In the situation described in Case Study 14.2, where the importer's profit margin exceeds the benchmarked range, the importer would be expected to make a supplemental payment to the exporter, thus increasing the importer's cost of goods and reducing the importer's profit margin. This supplemental payment would in turn be reported to customs, and any attendant duties would be paid. However, the facts of Case Study 14.2 specify that upon a post-import customs audit, it was discovered that no compensating adjustment is made. Consequently, the final profit margin exceeds the benchmarked range.

Not surprisingly, Case Study 14.2 concludes that absent the compensating adjustment, the transfer pricing study demonstrates that an arm's-length price did not result. Thus, the importer is precluded from using transaction value.

1 See "Technical Committee on Customs Valuation approves case study on transfer pricing" in the June 2016 issue of *TradeWatch*.



Caution for importers

As the norm is that a company utilizing an OECD profits-based transfer pricing method will make a compensating adjustment, in most situations, this case study will not be directly applicable. There are situations, however, in which the importer may choose not to make a compensating adjustment.

One situation that arises in practice occurs when the importer's profits are slightly in excess of the range, and, when considering the situation only from an income tax perspective, the tax department makes a practical assessment that in the country of importation, a higher than benchmarked profit means that income taxes are overpaid; consequently, an income tax authority will not criticize a decision to leave the situation alone. A customs authority, however, will have a different perspective, as a compensating adjustment would increase dutiable value and custom duties. Case Study 14.2 gives clear guidance that the compensating adjustment must be made for the transfer pricing to be used for customs purposes and, in fact, not making the adjustment is strong evidence that prices are not arm's length.

A second situation occurs when the country of importation has currency (or other income tax) controls in place that make supplemental payments out of the country for compensating adjustments difficult, if not impossible. In some cases, taxpayers prepare transfer pricing documentation with the understanding that no compensating adjustment will be made, but the transfer pricing study will demonstrate that income taxes were overpaid in comparison to similar situations. For importers in these countries this "strategy" is perilous when also considering customs: the income tax will remain overpaid, but transaction value will be rejected and customs value will be increased, resulting in more duties. Interestingly, this case study was brought to the TCCV by China, which has currency controls in place.

Finally, it is important for taxpayers to remember that for any compensating adjustment to be considered for customs purposes, it must be an actual payment for the goods. Customs authorities often look at the journal entries associated with the compensating adjustment to see that the adjustment impacted the importer's cost of goods. A "tax only," or "Schedule M," adjustment is not sufficient for customs purposes.

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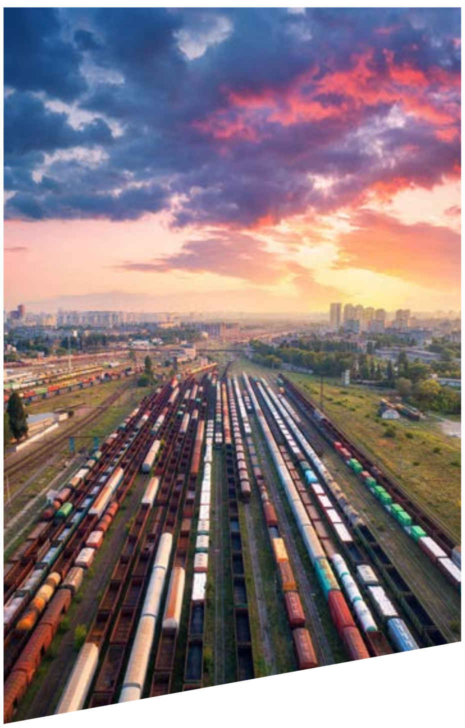
Agreement in principle reached on TPP-11: new agreement moves forward without the United States



After the United States' withdrawal from the Trans-Pacific Partnership (TPP), the remaining 11 countries have continued work to create a new agreement that maintains the original TPP content. Although there had been difficulty in reaching agreement regarding the list of provisions that would be suspended under the new agreement and there are still some remaining issues that need to be agreed upon, an agreement in principle would provide momentum toward the signing and ratification of the new agreement.

At the TPP ministerial conference on 9 November 2017, the parties reached such agreement in principle with respect to TPP-11. The package includes the legal text and a list of suspended provisions.

About TPP-11 and the suspended provisions

According to the Japanese Cabinet Secretariat, the TPP-11 agreement is formally called the "Comprehensive and Progressive Agreement for Trans-Pacific Partnership." The countries that were parties to the original TPP agreement, with the exception of the United States, will be parties to this new agreement, and the new agreement will cover 12.9% of global gross domestic product (GDP) and 14.9% of global trade by value.

The original TPP before the withdrawal of the United States (TPP-12) sought to liberalize and promote trade at multiple levels and included measures to eliminate tariffs and non-tariff barriers, liberalize investment and services, protect intellectual property rights and other measures. The agreement in principle provides that 20 items will be suspended in TPP-11. (Please see the table below for details.)

Furthermore, the parties agreed that further discussion will be required to determine whether four additional items, including the treatment of state enterprises, should also be suspended.

Benefits of TPP-11 for trade in goods and next steps

The list of suspended provisions and provisions requiring further discussion do not include any items directly affecting trade in goods (e.g., duty reduction schedules). In order for businesses to enjoy preferential duty rates under TPP-12, the goods being traded must fulfill prescribed origin requirements (value added, specific processes conducted, etc.). If the trade in goods provisions, as agreed to under TPP-12, are also adopted under TPP-11, this immediately provides new free trade partners for several of the TPP-11 countries; for example, this will be Japan's first free trade agreement with Canada, as well as with New Zealand.

TPP-11 contains accumulation provisions where parts originating in any member country will be considered as "originating" for the purposes of origin determination. This may allow businesses to fulfill origin requirements under TPP-11 where they were unable to do so under existing free trade agreements. Where goods fulfill the origin requirements of multiple free trade agreements, businesses will be able to compare the preferential duty rates available under each free trade agreement to determine which provides the greatest benefits.

Although the United States has withdrawn from the TPP, TPP-11 will provide significant benefits to businesses as described above. Therefore, it would be prudent for businesses to closely monitor the development of TPP-11 and implement the steps necessary to enjoy the full benefits of TPP-11.

List of suspended provisions (including partial suspension)
Express shipments
Investment agreement and investment authorization (investor-state dispute settlement (ISDS) related articles)
Express delivery services
Minimum standard of treatment (financial services)
Resolution of telecommunications disputes
Government procurement (conditions for participation)
Government procurement (further negotiations)
National treatment for intellectual properties
Patentable subject matter
Patent term adjustment for unreasonable granting authority delays
Patent term adjustment for unreasonable curtailment
Protection of undisclosed tests or other data
Biologics
Terms of protection for copyright and related rights
Technological protection measures
Rights management information
Protection of encrypted program – carrying satellite cable signals
Legal remedies and safe harbors for internet service providers
Conservation and trade
Transparency and procedural fairness for pharmaceutical products and medical devices

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Argentina

Argentina extends effective period for incentives to promote use of renewable energy sources

Argentina's Government has extended for periods of 12 months to 60 months the exemption from duties and other fees on certain imported capital goods, special equipment and parts used in projects for the generation of energy from renewable sources.

Law No. 27,191 of 2015[2] amends the Argentine system of incentives for the use of renewable energy sources. Expanded use of such sources is expected to have favorable consequences for the country as it implies greater diversification of the Argentine energy matrix, expansion of short-term installed power, reduction of energy generation costs, and better mid- and short-term predictability of prices. Increased use of renewable energy sources is also expected to help mitigate climate change by creating conditions for safe electric power supply in Argentina.

Chapter VI of Law No. 27,191 lists certain incentives, including exemption from payment of import duties and a number of other special taxes and other fees that are related to the importation of capital goods, special equipment and parts related to use of renewable energy sources.

Certain other requirements apply, for example, the goods must be new and must be intended for specified investment projects. These incentives, according to the law, are in effect until 31 December 2017.

Presidential Decree No. 814/2017[3] (the Decree), published on 10 October 2017, implements certain provisions of Law No. 27,191 and provides lists of goods in Annexes I, II and III to which these incentives apply. More importantly, the Decree extends the effective dates for the incentives as follows:

- Goods listed in Annex I of the Decree: starting 1 January 2018 for a period of 60 months
- Goods listed in Annex II: starting 1 January 2018 for a period of 12 months
- Goods listed in Annex III: starting 1 July 2018 for a period of 60 months

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[2] Text of law available in Spanish at: http://servicios.infoleg.gob.ar/infolegInternet/anexos/250000-254999/253626/norma.htm.

[3] Text of the Decree available in Spanish at: http://servicios.infoleg.gob.ar/infolegInternet/anexos/280000-284999/280655/norma.htm.

These incentives apply only if the final importer of the goods is:

1. The owner of a project for the generation, cogeneration or self-generation of electric power from a renewable source

Or

2. An individual or legal entity listed in the Registry of Manufacturers and Suppliers of Components for the Production of Electric Power from Renewable Sources

Businesses that can effectively make the most of these incentives can often secure a competitive advantage.

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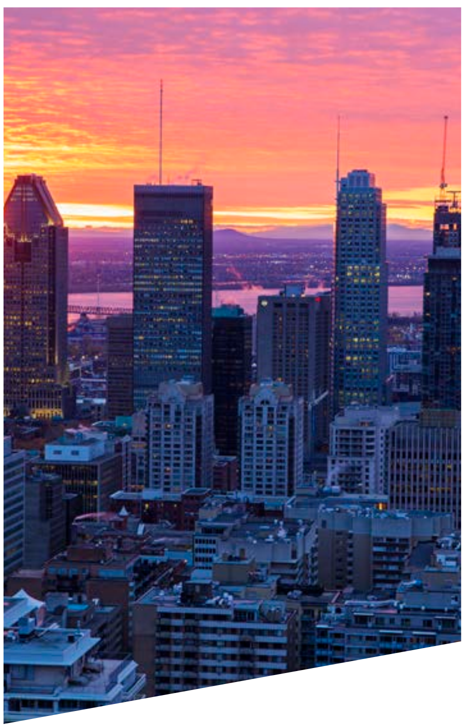
Canada

Canada designates its ninth "Foreign Trade Zone point" in Québec City



On 30 August 2017, the Canadian federal government announced that the Québec City metropolitan area is designated as a Foreign Trade Zone (FTZ) point. While Canada does not have designated FTZ sites such as in the US, it does have FTZ-type programs, such as customs bonded warehouses and duty deferral or drawback programs to eliminate or defer duties and import taxes. An "FTZ point" simplifies the application process to access Canada's FTZ programs, eliminates certain fees, introduces service standards for application processing times and enhances delivery of FTZ-type programs by having a "single window" to enhance delivery of FTZ programs at strategic locations in Canada. The Québec City FTZ point is the first in the province of Québec and the ninth in Canada. The decision to designate the region as an FTZ point is part of the federal government's drive to assist Canadian businesses to integrate into international markets and global value chains.

What is a FTZ point?

Canada's FTZ points are designated geographical areas where public and private organizations set up a task force to provide better access to government policies and programs, and thereby promote local and international trade.

The FTZ point program stems from a 2009 pilot project set up at the CentrePort Canada inland port in Winnipeg, where the federal government provided CentrePort with a single point of contact and coordinated service on FTZ programming. In August 2013, the federal government launched new measures to improve access to FTZ points by simplifying access to FTZ programs and eliminating certain registration fees.[4] Along with the new Québec City FTZ point, Canada hosts eight other FTZ points: CentrePort Canada (Manitoba), Calgary Region Inland Port (Alberta), Port Alberta (Alberta), Halifax Gateway (Nova Scotia), Global Transportation Hub Authority (Saskatchewan), Regional Municipality of Niagara (Ontario), Windsor — Essex Foreign Trade Zone (Ontario) and Cape Breton Regional Municipality Foreign Trade Zone (Nova Scotia).

FTZ points help businesses by reducing administrative burdens, improving cash flow, reducing operating expenses and increasing international competitiveness. These FTZ points are accessible to businesses regardless of their geographic location.

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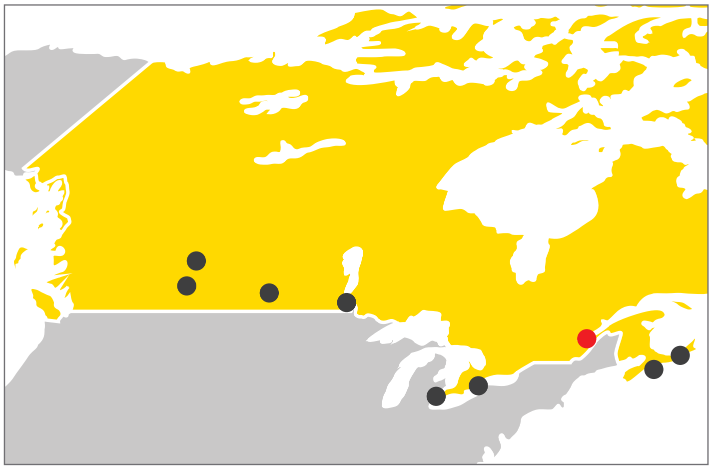
[4] See *EY Tax Alert — New Measures for Canada's Duty Relief and FTZ-type programs,* 2013 Issue No. 45, 10 September 2013.

Current FTZ points in Canada (Québec City in red)

The Québec City FTZ point will consist of a collection of programs that provide for the deferral, reduction or complete relief of import duties and taxes on goods imported into the FTZ point. The establishment of the FTZ point is the result of a partnership between Québec City and the city of Levis, Québec International, the Port of Québec and Québec City's Jean Lesage International Airport. The Québec City FTZ point will help businesses access information on the following programs.



FTZ-type programs as part of FTZ point delivery

Customs Bonded Warehouse (CBW) Program	Operators of licensed CBWs can enter imported goods into the licensed CBW's inventory on a duty- and tax-deferred basis, typically for up to four years. Importers can become CBW licensees or opt to use third-party service providers.
Duties Relief Program	This program enables participating importers to import (without payment of duties) goods to be warehoused or consumed, expended, or used in the production of other goods on a duty-deferred basis. Goods must be re-exported within four years.
Duty Drawback Program	Importers or exporters may recover duties previously paid on imports. In order to be eligible for drawback upon export, these goods must be exported out of Canada or must be used in the manufacture of goods exported within four years of importation.
Export Distribution Centre Program	Export-oriented businesses are granted full exemption from paying the Goods and Services Tax (GST) and Harmonized Sales Tax (HST) on import or domestic purchases destined for export. Only purchases of goods worth CAD1,000 or more are eligible.
Exporters of Processing Services Program	This program enables eligible businesses to import goods owned by nonresidents without paying GST or HST. Imports must be related to providing processing, distribution or storage services to the nonresident person and must be re-exported within four years.

Takeaway for businesses

The FTZ points facilitate access and reduce administrative costs and burdens to access the various trade programs available to importers and exporters in Canada, including importers and manufacturers located outside the geographical area of the FTZ point.

Companies may take advantage of the new FTZ point by executing current state assessments of their import and export activities to determine eligibility for duty planning programs and by preparing and submitting applications to eligible duty planning programs.

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CETA takes effect

After several delays, on 21 September 2017, Canada and the European Union formally implemented the Canada-EU Comprehensive Economic and Trade Agreement (CETA) on a provisional basis. CETA is the most ambitious Canadian trade agreement to date: as of implementation, 98% of Canadian and EU tariff lines are duty free, with another 1% of tariff lines to be staged out over a number of years. Canadian and European businesses will now have increased access to a market spanning approximately 535 million people.

Provisional application

The European Council's decision of 5 October 2016 allowed all but the contentious investment dispute provisions of CETA to apply on the day that the EU and Canada exchange letters of agreement. This occurred on 8 July 2017 with 21 September as the provisional in-force date. (There is a 180-day period from this date to enact immigration law regulations to allow professional mobility business visitor visa rules, although Canada has already enacted its new rules.)

Full ratification of CETA still requires unanimous support from all 28 EU Member States, and provisional application will exclude specific provisions having to do with:

- Investment protection
- Investment market access with regards to portfolio investment
- The Investment Court System

These controversial provisions may delay or postpone the ongoing ratification process as there is no scheduled timetable for full ratification of the agreement. To date, Latvia, Malta and Denmark are the only EU Member States to have ratified CETA. It is unclear what impact failure to ratify would entail.

Increased market access

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

The following tariff changes came into force upon provisional application of the agreement:[5]

- **Industrial goods:** 99.6% of Canadian tariff lines on industrial goods and 99.4% of EU tariff lines were eliminated. The remaining tariff lines will be gradually eliminated over seven years after entry into force of CETA.
- **Fish:** Canada eliminated all tariffs on imported fish products, and the EU eliminated 95.5% of its tariffs. Any existing tariff rate quotas (TRQs) will expire once the duties of the relevant tariff lines are fully eliminated.
- **Agriculture:** Canada eliminated duties for 90.9% of all agricultural tariff lines, while the EU eliminated 92.2% of its agricultural tariffs. Under CETA, Canada also established a TRQ for imports of dairy products (cheese) from the EU. As for the EU, it granted additional market access to Canadian exporters through a TRQ system for beef, pork and sweet corn. Duty-free (in-quota) status for these agricultural products will be phased in over a five-year period.[6]

Access to government procurement

Under CETA, Canadian suppliers will benefit from access to all levels of the EU procurement market, which is estimated at approximately CAD3.3 trillion per year. Canada and the EU's commitments with respect to government procurement are contained in Chapter 19 of the agreement.

Origin quotas under CETA

In most cases, whether goods qualify as "originating" — and therefore are eligible for preferential tariff treatment — will depend on meeting the product-specific rules of origin contained in Annex 5 of CETA's *Protocol on Rules of Origin and Origin Procedures* (the Protocol).[7]

However, Canada and the EU also established several "within access" origin quotas to allow set quantities of certain listed goods to qualify as originating under an alternative set of product-specific rules.

Origin-quota eligible goods, associated product-specific rules of origin, and annual quota allocation amounts are contained in Annex 5-A of the Protocol. These origin-quota goods include certain:

- Agriculture products
- Fish and seafood
- Textiles and apparel
- Vehicles

Importers and exporters that wish to trade origin-quota eligible products should be mindful of associated export and import permit requirements that Canada established under the Export and Import Permits Act (EIPL). All textile and apparel imports under Canadian origin quotas require an import permit issued by Global Affairs Canada, while exports to the EU of certain sugar confectionery and chocolate preparations, processed foods, dog and cat food, and vehicles require an export permit. No Canadian export permits are necessary for fish and seafood or textile origin-quota eligible products.

Rules of origin

The CETA rules of origin incorporate best practices from other Canadian and European free trade agreements (FTAs), as well as the North American Free Trade Agreement (NAFTA), and are an improvement over NAFTA's rules of origin from a simplification point of view. The CETA rules are also more flexible; although, this could lead to uncertainty.

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[5] European Commission statement, *CETA — Summary of the Final Negotiating Results,* European Commission, 2016 available at: http://trade.ec.europa.eu.

[6] See Annex 2-A of the CETA text.

[7] Global Affairs Canada, *CETA Origin Quotas* available at: www.international.gc.ca/controlscontroles/prod/ceta_origin_quotas-contingents_origine_aecg.aspx?lang=eng.

Certain of the rules stem from the Canada-European Free Trade Association Free Trade Agreement.[8] Goods generally will originate for purposes of CETA if:

- They are "wholly obtained," such as goods that are grown, raised, caught or extracted in Canada or the EU.
- They are produced in Canada or the EU entirely from originating materials.

Or

- They are produced in Canada or the EU from some non-originating materials that undergo sufficient production in Canada or the EU such that the resulting good satisfies the applicable product-specific rule of origin (PSRO) set out in Annex 5 of the Protocol and meet certain origin quotas (e.g., vehicles).

CETA also contains provisions that open the possibility for cross-cumulation of origin. This means that products originating in a country with which both Canada and the EU have a free trade agreement (e.g., Mexico) may be considered in determining whether a product is originating under CETA. Additionally, should the EU and the US enter into a free trade agreement, producers will be entitled to count US materials toward the originating status of Canadian or EU goods of Chapter 2 or 11, heading 16.01 through 16.03, Chapter 19, heading 20.02 or 20.03, or subheading 3505.10, subject to agreement by Canada and the EU on the applicable conditions.

CETA introduces new procedures for validating the origin of goods that are different from the ones Canadian businesses have become accustomed to under NAFTA. For example, CETA recognizes proof of origin of goods based on an "origin declaration" rather than a "certificate of origin" under NAFTA. The origin declaration is an exporter self-certification process, whereby the exporter attests to the originating status of the goods by placing a prescribed statement on the invoice or other relevant commercial documentation.[9] EU exporters will need to provide a Registered Exporter (REX) number and provide it in field 2 of the origin declaration, and Canadian exporters will need to provide their business number (BN) in the same field. Currently, EU exporters that are not yet registered for REX can simply add their signature in field 5 of the origin declaration in place of the REX number; however, as of 1 January 2018, EU exporters will have to be registered for REX.

New origin verification procedures

CETA introduces new origin verification procedures for the respective customs authorities to verify the originating status of goods *exported from their own jurisdictions*. Regulations setting out the new verification procedures under CETA were announced on 14 September 2017 by the Canada Border Services Agency (CBSA) but have not yet been released.[10] These new procedures are likely to carry important compliance and record-keeping obligations relevant to exporters.

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8 Global Affairs Canada, *Canada-European Union Comprehensive Economic and Trade Agreement – Canadian Statement on Implementation, Canada Gazette,* Part 1, Vol. 151, No. 37, 16 September 2017.

9 The statement can be found in Annex 2 of the Protocol on Rules of Origin and Origin Procedures.

10 See Customs Notice 17-29, *Proposed Regulatory Amendments and Proposed New Regulations Related to the Implementation of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA).*

Are businesses ready for CETA?

Beyond the reduction in tariffs, which is a dramatic change for Canadian importers and exporters to take advantage of, transatlantic businesses must deploy change management strategies to tackle the operational changes and challenges that will be brought on by CETA. Potential change management challenges under the new rules include the following:

- CETA preferential tariff users may obtain potentially better cost to market that requires application of new proof-of-origin rules (especially challenging with regards to supplier compliance functions).
- Some exporters may face new "rules of origin derogations" for exports that will allow certain non-originating products to be deemed originating, e.g., in the textile and apparel industry.
- Some importers will require new preferential quotas and import or export permits to enjoy new market access.
- Newly protected "geographical indications" for agri-food products mean protection for European producers but potentially new marketing compliance burdens for Canadian producers.

New rules respecting the migration of professionals and the recognition of professional qualifications (mutual recognition agreements or MRAs) need to be considered by human resources functions. Within 180 days after the entry into force of CETA, Canada and the EU must make available clarifications for the following:

- Requirements that pertain to temporary entry for business and professional travelers. Canada has already released new instructions for temporary entry of business persons under CETA.[11]
- Special rules that will allow for the preferential treatment of certain services provided by European vessels in Canadian waters, such as marine dredging, but these will likely be subject to specific compliance issues.
- Procurement and contract managers will need to consider new rules respecting public procurement to claim national treatment for their bids.

The Government of Canada describes CETA as setting "new standards for trade in goods and services, non-tariff barriers, investment, government procurement, as well as in areas like labor and the environment."[12] It is a progressive free trade agreement that covers virtually all sectors and aspects of Canada-EU trade to eliminate or reduce trade barriers. Canadian businesses are urged to examine the benefits and challenges under CETA that affect business competitiveness as new opportunities also bring new business disruptors. Canadian businesses must be prepared for the changes and challenges that lie ahead.

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[11] Government of Canada website, new instructions for the temporary entry of business persons under the Canada-European Union (EU) Comprehensive Economic and Trade Agreement (CETA), accessed via http://www.cic.gc.ca/english/resources/tools/updates/2017/07041530.asp, 21 September 2017.

[12] Government of Canada brochure: The Comprehensive Economic and Trade Agreement is a big deal for Canadian companies, http://www.international.gc.ca/gac-amc/campaign-campagne/cetaaecg/brochure.aspx?lang=eng&wbdisable=true.

Trade compliance verification list update

On 7 July 2017, the Canada Border Services Agency (CBSA) released its semiannual list of current trade compliance verification (audit) priorities. Every year, the CBSA releases its verification priorities in January, followed by a midyear update in July. The midyear release is designed to update the public on the progress of the verifications thus far, as well as set the stage for new priorities for the balance of the calendar year.

The midyear update just released identifies that the agency remains focused on tariff classification as a priority audit area, with the introduction of three new tariff classification product categories added to the list of already existing priorities.

Background

The CBSA uses trade compliance verifications to ensure that importers comply with customs legal requirements and programs. The main objectives of conducting verifications are to:

- Assess an importer's compliance with CBSA-administered legislation
- Determine compliance within industry sectors
- Conduct a review of an importer's liabilities and entitlements
- Assess the integrity of trade data received from importers

The CBSA manages trade compliance within three specific program categories: **tariff classification, valuation** and **origin**, using two post-release verification processes: random verifications and targeted verification priorities.

Random verifications

Random verifications, which are selected using a statistical model, are designed to measure compliance rates and revenue loss, and the results may be used by the CBSA for many purposes, including risk assessment (which may lead to targeted verification priorities — see below), revenue assessment and the promotion of voluntary compliance.

Targeted verification priorities

Targeted verification priorities are determined through a risk-based, evergreen process, so that new targets are added throughout the year. Verification priorities may also be carried over from previous years.

It's important to note that importers that deal in products or industries that are not included in the trade compliance verification priorities listing should not presume they will not be subject to a verification. Through random verifications, the CBSA continues to verify importers in sectors and industries not included in the list of verification targets.

Verification priorities: updated targets

The midyear trade verification priorities list encompasses 41 tariff classification verification priorities, including three new priorities for classification in the second half of 2017, as well as one valuation verification priority and two origin verification priorities.[13]

The primary focus of the CBSA's trade compliance verification priorities for the second half of 2017 remains tariff classification. The continued focus on tariff classification may be due to the relative ease of verifying that goods have been classified correctly for customs purposes. Increased audit activity in this program may also lead to higher revenues for the CBSA.

The following chart lists all current tariff classification priority items.

Verification priority: tariff classification

- Curling irons
- Spectacle lenses
- Furniture for non-domestic purposes *(new additional round)*
- Seaweed (new additional round)
- Dextrins and other modified starches *(new additional round)*
- Disposable and protective gloves
- Batteries
- Footwear *(CAD30 or more per pair)*
- Hair extensions *(new additional round)*
- Special-purpose motor vehicles
- Parts for power trains
- Geophysical and oceanographic instruments
- Cereals
- Articles of apparel and clothing accessories
- Bicycle parts
- Articles of plastics *(new additional round)*
- Vices and clamps (new additional round)
- Parts for use with machinery of Chapter 84
- Tubes, pipes and hoses
- Parts of lamps *(new additional round)*
- Chemical products *(new additional round)*
- Pasta *(new additional round)*
- Hair dryers and electric smoothing irons
- Cell phone cases
- Mountings, fittings and similar articles
- Stone table and countertops
- Prepared meat of swine
- Interchangeable tools
- Air brakes and parts thereof
- Handkerchiefs, towels and related paper products
- Olive oil
- Photographic film
- Stone blocks and slabs
- Railway equipment
- Sausages and similar products
- Sacks and bags under Tariff Item 9903.00.00
- Yeasts and other micro-organisms *(new)*
- Nails and similar articles of iron or steel *(new)*
- Castors with mountings of base metal *(new)*
- Pickled vegetables *(new additional round)*
- Live plants

[13] The full listing of CBSA trade compliance verification priorities can be found on CBSA's website: CBSA Trade Compliance Verifications available at: https://www.cbsa-asfc.gc.ca/import/verification/menu-eng.html.

As shown in the chart, the CBSA has identified three product categories as new **tariff classification** verification priorities: yeasts and other microorganisms, nails and similar articles of iron or steel, and castors with mountings of base metal, while having opened an additional round of verification for 10 tariff classification verification priorities.

There are no new **valuation** verification priorities added for the second half of 2017. However, the CBSA remains focused on the previously identified target, the apparel industry, by having opened a third round of verification in April 2017. The risks for the apparel industry remain high due to the high duty rates associated with apparel (duty rates vary between 10% and 18%). The CBSA stands to generate increased revenues if the agency determines that imported goods ought to be re-classified and a higher rate of duty applies. According to the CBSA, during the second round, 35% of importers were found to be noncompliant, and the CBSA's findings resulted in over CAD5 million (approximately USD3.92 million) in revenues so far.

It is strongly recommended that importers of apparel and similar fashion articles (e.g., footwear, fashion accessories, imitation jewelry) carefully consider whether they are prepared for a valuation program verification audit. Importers that purchase goods from related parties and that utilize a transfer price as the basis for their customs values should be especially careful about the level of documentary support on record to defend their use of a transfer price as the basis for a transaction value.

Two origin verification priorities listed by the CBSA remain ongoing since the last listing of verification priorities and relate to the North American Free Trade Agreement (NAFTA). The purpose of a NAFTA origin verification is to determine whether goods imported into Canada are entitled to a preferential rate of duty accorded under NAFTA. These two priorities include T-shirts and jewelry. For the current rounds of verifications in place (second round for T-shirts and first round for jewelry), approximately 25% of importers have been found deficient from a compliance perspective, and the CBSA's targeted enforcement initiatives have generated just under CAD300,000 (approximately USD235,140) in revenues so far.

Takeaways for importers

CBSA verifications can be time-consuming and costly for importers. Now, more than ever, importers' reasonable care in respect of compliance programs and processes is under scrutiny. It is important for companies to be proactive and to adopt an informed compliance mindset. Best practices include implementing programs, frameworks and methodologies that help organizations maintain and continuously improve upon their customs and trade compliance profile.

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Colombia

Import duty rates for certain capital goods and raw materials reduced to 0%

In line with the Plan Colombia Repunta[14] economic stimulus program and the Plan to Promote Productivity and Employment (PIPE: Plan de Impulso a la Productividad y el Empleo), the Colombian Ministry of Commerce, Industry and Tourism (MinCIT: Ministerio de Comercio, Industria y Turismo) has issued Decree 1343 of 11 August 2017[15] (the Decree), which partially modifies the 2017 Colombian Harmonized Tariff Schedule.[16] The Decree reduces to 0% import duties for certain capital goods and raw materials that are not being produced in Colombia. Article 1 of the Decree provides a list of subheadings to which the 0% duty rate applies.

The purpose of this duty reduction is to encourage private investment and to make local businesses more competitive.

The MinCIT will review annually the customs duty rate established by the Decree and update the list of subheadings according to the recommendation of the Superior Council for Fiscal Policy (CONFIS: Consejo Superior de Política Fiscal).

The customs duty rate established by the Decree became effective on 16 August 2017.

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[14] Literal translation: "Colombia Rebounds Plan."

[15] The text of Decree 1343 of 11 August 2017 is available in Spanish at: www.mincit.gov.co/loader.php?lServicio=Documentos&lFuncion=verPdf&id=5175&name=DECRETO_1343_DEL_11_DE_AGOSTO_DE_2017.pdf.

[16] The 2017 Colombian Harmonized Tariff Schedule is found in Decree 2153 of 2016 available in Spanish at: www.suin-juriscol.gov.co/viewDocument.asp?id=30030336.

Mexico

Update on Special Economic Zones in Mexico

In the September 2016 issue of *TradeWatch*, we detailed the Mexican Government's efforts to promote economic activity in regions with high poverty rates by creating the framework for operation of Special Economic Zones in Mexico under Federal Law on Special Economic Zones of 1 June 2016. The Mexican Government has now issued specific Decrees (published on 29 September 2017) establishing the benefits that will be exclusive to each authorized zone.

The first three Special Economic Zones are located in Puerto Chiapas, Coatzacoalcos and Lázaro Cárdenas-La Unión. The Decrees define the geographic limits of the zones and their area of influence, as well as establish both the customs regime and the tax incentives that apply to the zone operators.[17]

Customs benefits

The Decrees establish a Special Economic Zone customs regime whereby foreign goods are admitted into the zones for a limited time for manufacturing and other economic activities.

Goods admitted into the zones are not subject to payment of duties (except for those that will be exported to the US or Canada for purposes of NAFTA's article 303) and will not be required to comply with nontariff restrictions. The goods entered into the zones may remain for a period of up to 60 months, except for machinery and equipment, tooling, molds and other assets used in the productive process, which may remain in the zones for the duration of the authorization issued to zone operators.

Under the Special Economic Zones customs regime, goods may be withdrawn for permanent importation into Mexico, permanent exportation or return abroad or they may be destined to another temporary import regime (e.g., the IMMEX[18] temporary import regime, the strategic bonded warehouse regime). Goods may be transferred between operators in the same zone or they may also be transferred between the operators of one zone and the operators of another zone.

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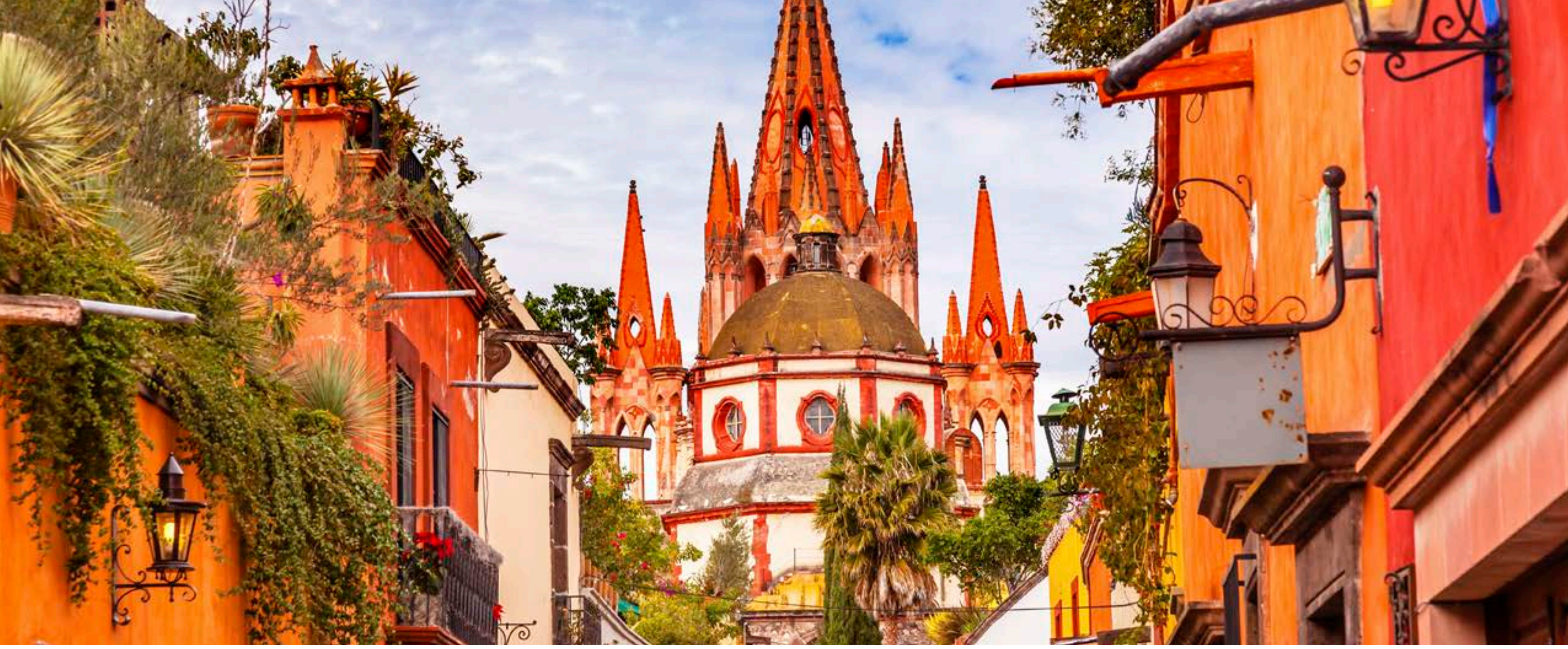
[17] The zone operators include the Integral Administrator and the investors. The Integral Administrator has responsibility for the construction, development, management and maintenance of the zone. The investors can be Mexican or foreign entities or individuals that do business in the zone.

[18] From *Industria Manufacturera, Maquiladora y de Servicios de Exportación,* Promotion of the Manufacturing, Maquila and Export Service Industry. IMMEX is a program authorized by the Mexican Ministry of Economy under the Decree for the Promotion of the Manufacturing, Maquiladora and Export Services Industries.



Tax incentives

The operators in the zones will also benefit from various tax incentives. From an indirect tax perspective, these include the following:

- Any activities performed within the zones that are subject to VAT (value-added tax) will be exempt from payment, effectively turning these Special Economic Zones into a VAT-free area.
- Sales from Mexican entities or individuals outside the zones to zone operators will be subject to a 0% VAT rate. Additionally, services rendered to zone operators will be subject to a 0% VAT rate.
- The admission of foreign goods into the zones does not constitute an importation; therefore, no VAT will apply. It is important to note that no additional certification is required to obtain this benefit, as in the case for VAT credits applied on temporary imports for IMMEX companies or strategic bonded warehouses.
- When goods are withdrawn from the zones for importation into Mexican territory, they will be subject to the applicable import VAT rate; however, the sale of the goods will not be subject to any sales VAT.
- The customs regime for the zones does not provide any benefits in relation to excise taxes. Therefore, the admission of goods into the zones will be considered as a permanent importation for purposes of excise tax that must be paid at the time of admission.

From an income tax perspective, zone operators will be eligible to apply a tax credit during the first 10 years of operation of up to 100% of the income tax payment otherwise due, and, after the first 10 years, zone operators will be eligible to apply a tax credit of 50% of the tax payment otherwise due for an additional five years.

Expiration of benefits and restrictions

The benefits established for zone operators will only be applicable for a period of 15 years counted from the date on which the permit or authorization to perform activities in the zone is obtained.

Zone operators are prohibited from performing any activities related to the refining of oil and processing of natural gas, as well as the storage, transport, distribution and sale of hydrocarbons and petroleum products to anyone outside the zone.

For companies that operate in Mexico as toll manufacturers, it is important to note that companies that operate as "maquilas" within the zone (i.e., carrying out manufacturing activities on behalf of a foreign principal that owns the raw materials and finished goods) may not be able to benefit from the permanent establishment exemption that would otherwise apply (therefore, foreign principals that own the raw materials and finished goods may be considered to have a permanent establishment in Mexico).

The first sections of the zones are expected to be in operation by 2018, and the Mexican Government is already expecting significant investments in these zones. Other zones are expected to be established throughout Mexico as well. The establishment of the Special Economic Zones could generate potential business opportunities. Companies are advised to conduct a detailed analysis of ways the zones can be of benefit and specifically of ways to take advantage of a favorable customs regime and significant tax incentives.

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United States

Seldom used Section 201 of the Trade Act of 1974 roars back in action

What do crystalline silicon photovoltaic cells (solar cells) and large residential washers (washers) have in common? Probably not much on a daily basis, but they are the two products under Section 201 of the Trade Act of 1974 (Section 201)[19] investigations conducted by the International Trade Commission (ITC or Commission) this year. The two investigations have been dominating trade news headlines lately, as the ITC has determined unanimously in both cases, within roughly two weeks of each other, that imports of these products have caused "serious injury" to their respective domestic industries. As a result, imports of the aforementioned products may soon be subject to, among others, additional duties, quantitative restrictions and tariff-rate quotas.

Overview

Section 201 is often referred to as the "global safeguard" provision because it is broader-sweeping than the more commonly known trade remedies of antidumping and countervailing duties (AD/CVD). Under the Tariff Act of 1930, AD/CVD consist of additional duties on imported goods that are deemed to be priced below fair market value. Unlike AD/CVD, Section 201 action does not require the lengthy determination of unfair trade practice, nor is it country-specific when imposed, meaning that it applies to imports from all foreign countries. Section 201's requisite of a "serious injury" (or threat of a serious injury) finding is a higher injury standard than AD/CVD's "material injury" standard.

In fact, the petitioners in the solar cells and washers cases sought AD/CVD protections first and were issued AD/CVD orders (in 2012 and 2015 for solar cells; in 2013 and 2017 for washers) before finally invoking the Section 201 global safeguard provision. Although they were awarded AD/CVD relief, they did not find AD/CVD effective because the specific nature of AD/CVD laws allows foreign importers to build supply chains in non-AD/CVD-applied countries and to continue importing the same products into the US under regular conditions. The protection of AD/CVD seems limited in light of the evolving supply chains in these and other industries.

Historical trend

Section 201 of the Trade Act of 1974 has been an obscure part of the Trade Act because few companies have been willing to use it or have successfully invoked it as a trade strategy in recent years. Prior to the current cases, a petition on primary unwrought aluminum was filed in April 2016 but was later withdrawn in May 2016, so a full investigation did not take place.

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[19] 19 U.S.C. § 2252.

From 1996 to 2001, there were nine Section 201 filings and ITC investigations with three non-injury findings and six injury findings. Products that were investigated during this period include the following: extruded rubber thread, crabmeat from swimming crabs, fresh tomatoes and bell peppers, steel, circular welded carbon quality line pipes, steel wire rods, lamb meat, wheat gluten and broom corn brooms. In the first three cases above, the ITC determined that these products were not being imported into the United States in "increased quantities as to be a substantial cause of serious injury or the threat thereof, to the domestic industry producing an article like or directly competitive with the imported article."[20]

The latest completed Section 201 investigation took place more than a decade ago in 2001, and, as a result, President George W. Bush imposed up to 30% tariff on steel imports over a period of three years. The initial tariff was later dramatically scaled back with hundreds of exclusions[21] (around 500 additional excluded products by 2003).[22] The exclusions represented a quarter of all foreign steel imports entering the US under regular conditions.[23] Since then, use of the Section 201 mechanism has been dormant until this year when representatives of the solar cells and the washers industries filed petitions.

Section 201 procedural timeline

Section 201 has three procedural phases:

1. ITC's serious injury (or threat of serious injury) determination
2. ITC's remedy recommendations
3. The President's final decision

The solar cells and washers cases have completed the injury determination and remedy phases, with the release of recommendations on 31 October 2017 and 21 November 2017, respectively, all prior to the deadlines set on 13 November 2017 (for solar cells) and on 4 December 2017 (for washers) for the submission of reports to the President. At the time this article was prepared, the President will be making final decisions based on the Commissioners' recommendations. Details of each phase are as follows.

1. Injury determination phase

Whenever a petition is filed, the ITC must make an injury finding within 120 days. The investigation timeline may be extended to 150 days if extraordinarily complicated circumstances exist. During the investigation phase, the ITC will issue questionnaires to relevant parties and review documents submitted by interested parties. When a finding of serious injury (or threat of a serious injury) occurs, the remedy phase follows.

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[20] 19 U.S.C. § 2252 (b)(1)(A).

[21] Exclusion of Particular Products From Actions Under Section 203 of the Trade Act of 1974 With Regard to Certain Steel Products, 67 FR 46221 (12 Jul. 2002); Exclusion of Particular Products From Actions Under Section 203 of the Trade Act of 1974 With Regard to Certain Steel Products, 67 FR 56182 (30 Aug. 2002); Exclusion of Particular Products From Actions Under Section 203 of the Trade Act of 1974 With Regard to Certain Steel Products, 68 FR 15494 (31 Mar. 2003).

[22] Steel: Evaluation of the Effectiveness of Import Relief, Inv. No. TA-204-12, USITC Pub. 3797 (Sept 2005) at 39.

[23] "Bush Scales Back Tariffs on Steel," *The New York Times*, http://www.nytimes.com/2002/08/23/business/bush-scales-back-tariffs-on-steel.html, accessed 13 October 2017.

2. Remedy phase

During the remedy phase, the ITC must hold public hearings to decide what the remedies should be. The ITC may recommend additional tariffs, quantitative restrictions, tariff-rate quotas (tariffs that are imposed after imports exceed certain predetermined levels), trade adjustment assistance to the US industry and its workers, or any combination of the actions described above. Interested parties may submit letters of exclusions to explain why they should be excluded from additional tariffs or quotas in the future.

After the remedy hearings, the ITC prepares a report with recommendations to the President. The report includes:

1. Explanation of the basis for the determination
2. Recommendations for action
3. Dissenting views by members of the ITC on the determination and recommendation
4. Short- and long-term effects of implementing or not implementing the recommended action on the domestic industry, its workers and consumers

The Commissioners have recommended the following remedies as well as exclusions for solar cells and washers:

Solar cells

The Commissioners did not reach a unanimous decision with respect to the penalties, as they had done in the washers case presented below. Three distinctive views, from most to least restrictive, are highlighted as follows:

- Chairman Rhonda K. Schmidtlein presented a penalty consisting of a 10% tariff-rate quota (TRQ) on the first imported 0.5 gigawatts of solar cells and a 30% tariff for above the quota volume level. She also recommended that a 35% tariff on modules be lowered by 1% for each of the subsequent years of the remedy period, as indicated below.[24]
- Vice Chairman David S. Johanson and Commissioner Irving A. Williamson presented the next level of restrictive penalty consisting of a TRQ of a 30% tariff on imports of solar cells in excess of 1 gigawatt, as well as a 30% tariff on modules. They also recommend that, for each subsequent year, the in-quota amount be increased by 0.2 gigawatts while the tariff rate be decreased by 5%.
- Commissioner Meredith M. Broadbent presented the least restrictive penalty by capping, in the first year, the import of cells, modules and other photovoltaic products to 8.9 gigawatts (the import level she believed to be consistent with 2016s) and then to increase the cap by 1.4 gigawatts for each subsequent year. Her recommendation wishes to prevent a surge in imports without causing disruption to the current market.

Chairman Schmidtlein recommended remedy Cells: tariff-rate quota	Year 1	Year 2	Year 3	Year 4
In-quota tariff rate	10.0%	9.5%	9.0%	8.5%
In-quota volume level	0.5 gigawatts	0.6 gigawatts	0.7 gigawatts	0.8 gigawatts
Out-of-quota tariff rate	30%	29%	28%	27%
Modules: tariff (ad valorem)	35%	34%	33%	32%

24 Only Chairman Rhonda K. Schmidtlein's recommendations are available in the table format in the solar cell's public report.

Washers

The Commissioners unanimously recommend that the President impose a tariff-rate quota on imports of large residential washers, as well as covered parts, at 50% ad valorem in addition to their current duties, for a duration of three years. The recommended in-quota level for washers is 1.2 million units, while the recommended in-quota level for covered parts is 50,000 units. The quota level for the washers will remain the same during the remedy period, while the covered parts will be increased by 20,000 units in each year of the remedy period. The above-quota tariff rate, or 50% ad valorem for the first year, will be decreased by 5% points over the next two years of the remedy period. Additionally, Chairman Schmidtlein and Commissioner Williamson introduced variations (for the washers only) by recommending a 20% in-quota tariff to be reduced by two percentage points the second year and by three percentage points the third year.

Exclusions

For the washer case, the Commissioners recommend that imports from Canada and Mexico be excluded from the above TRQs and increased rates of duty due to negative findings with respect to imports from Canada and Mexico under Section 311(a) of the North American Free Trade Agreement Implementation Act.

Meanwhile, in the solar case, the Commissioners only recommend to exclude Canada from the quantitative restriction and increased rates as there is an affirmative finding with regards to imports from Mexico. Vice Chairman Johanson and Commissioner Williamson recommend 720 megawatts of solar cells for the first year to be increased by 115 megawatts for each subsequent year of the remedy period.

For both the solar cells and washer cases, the Commissioners recommend that the above TRQs and increased rates of duty not apply to imports from Australia, Colombia, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Nicaragua, Panama, Peru and Singapore or to imports from the beneficiary countries under the Caribbean Basin Economic Recovery Act.

3. Presidential action phase

The President must take action within 60 days after receiving an ITC report with an affirmative injury determination. The President may later reduce, modify, terminate or extend the action, depending on circumstances.

Summary of the Commissioners' recommended actions			
Large residential washers	Year 1	Year 2	Year 3
Large residential washers: TRQ			
In-quota volume level	1.2 million units	1.2 million units	1.2 million units
Above-quota tariff rate	50%	45%	40%
In-quota tariff rate (Schmidtlein & Williamson)	20%	18%	15%
In-quota tariff rate (Johanson & Broadbent)	0%	0%	0%
Covered parts: TRQ			
In-quota volume level	50,000 units	70,000 units	90,000 units
Above-quota tariff rate	50%	45%	40%

What to expect

In the solar cells and washers cases, the petitioners have proposed the maximum legally allowable tariff rate of 50% ad valorem. Many companies in the respective industries have opposed such dramatic measures and have generally advocated for the ITC to recommend technical assistance, financial assistance and/or trade adjustment to mitigate the injury and to stimulate economic growth.

A final hearing was held on 6 December 2017 with the United States Trade Representative (USTR) for the Solar Energy Industries Association (SEIA) to voice its last arguments against the solar cells petitioners' proposed remedies. Instead of imposing tariffs on solar cells, SEIA has advocated for import license fees. Additionally, the USTR has requested the ITC to submit a supplemental report to the aforementioned recommendations to the President. The report is designed to further assist the President with determining an appropriate strategy to help the solar cells industry adjust to import competition.

Once presented with the ITC recommendations, the President may request additional information or, if none is needed, the President will make decisions on the course of actions to be taken by January 2018 and February 2018, respectively, at the time this article was prepared. Effective dates of the penalties, whether in the form of tariffs, quotas or quantitative restrictions, will be in place 15 days after the day the presidential action is announced. If the President decides to initiate negotiations with countries under the statute, the effective date will be within 90 days after the date of such decision. Thus, effective dates, at the time this article was prepared, for the imposed remedies for the solar cells and the washers may be extended to April 2018 and May 2018, respectively.

Importers of the subject items should monitor the President's actions closely and consider alternative sourcing and manufacturing options. Importers in general are advised to keep a close watch of potential Section 201 filings in other industries, as support for use of the Section 201 mechanism appears to be in favor with the new administration. Active participation in the hearing phases will play an important part during injury determination, as well as exclusions from penalties in cases of affirmative injury decision.

Look for updates in future issues of *TradeWatch*.

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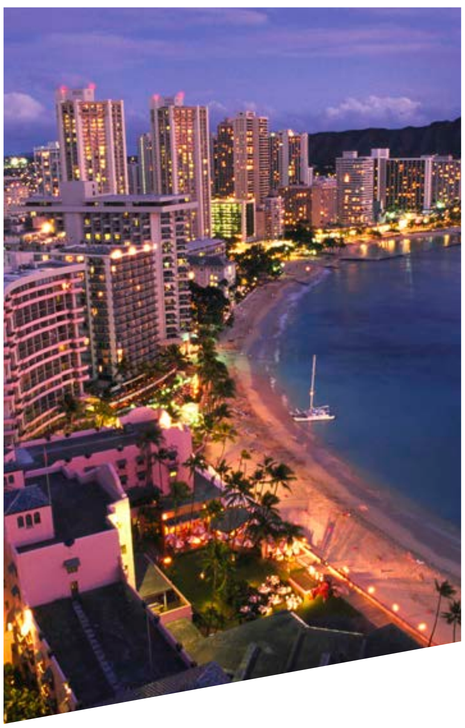
GSP: recent developments



In the September 2015 issue of *TradeWatch*, we highlighted the Trade Preferences Extension Act of 2015 that renewed the US Generalized System of Preferences (GSP) through 31 December 2017. Unless Congress renews GSP before this expiration date, starting 1 January 2018, the importation of some 5,000 tariff items from 120 designated beneficiary countries and territories will no longer be eligible for duty-free importation until such time that Congress takes action.

Additionally, there have been some new initiatives to amend the GSP to establish enforcement priorities and to update the beneficiary country review process. Considering the current environment surrounding trade benefits that impact the US economy, importers should pay close attention to GSP renewal and review activity.

Background

Along with similar programs in other developed countries and customs unions, the GSP was established under the Trade Act of 1974[25] to promote economic growth and development in developing and least developed designated countries. GSP beneficiary members undergo annual reviews by the US Trade Representative (USTR) to establish their continued eligibility. The requirements are based on meeting the 15 eligibility statutory criteria.[26] Most recently, on 1 January 2017, Uruguay, the Seychelles and Venezuela became ineligible for GSP treatment.

In its current form, the US Congress must reauthorize GSP periodically. The GSP has expired several times in the past (most recently on 31 July 2013) and was each time renewed retroactively to its expiration date. As such, duties paid on qualifying goods that entered the United States during the GSP's lapsed period may be refunded subject to certain requirements.

Many US importers depend on GSP duty savings to reduce their import costs on materials used in their domestic manufacturing processes.

GSP renewal

The nearing expiration of the GSP is causing uncertainty among US businesses. In an effort to promote speedy renewal of the GSP before it expires, a group of congressmen have submitted a bipartisan letter dated 27 October 2017[27] to the Committee on Ways and Means to include the GSP among its top priorities. The letter

[25] 19 U.S.C. 2461.

[26] 19 U.S.C. 2462(b)(2) and 19 U.S.C. 2462(c).

[27] The text of the letter is available at: https://norman.house.gov/uploadedfiles/gspletter.pdf.

discusses the impact of the GSP on US businesses and indicates that in 2016 alone, the GSP eliminated roughly USD730 million in tariffs.

It is important to mention here that the expiration of the GSP will have no impact on the African Growth and Opportunity Act (AGOA), which remains in effect until 30 September 2025.

Considering that Congress has always renewed the GSP in the past, albeit sometimes months after expiration, it is likely that Congress will renew the GSP this time as well. Unfortunately, there is no way to predict when this will happen.

New enforcement priorities

The USTR has initiated new enforcement priorities and requirements of GSP beneficiary countries.[28] These priorities focus on concluding outstanding GSP cases, as well as adding a new interagency process to assess beneficiary country eligibility. The new process, according to the USTR, will complement the existing petition receipt and public input process for country practice reviews.

The new additional process will involve a triennial assessment by the USTR and other relevant agencies to determine the continued compliance of the GSP beneficiary with the statutory eligibility requirements. The USTR announced that Asian GSP beneficiary members will be reviewed in the first year, followed by GSP members from other parts of the world in the second and third years.

The proposed GSP Footwear Act of 2017

On 30 October 2017, a new bill was introduced into Congress to amend the GSP. The GSP Footwear Act of 2017[29] bill aims to make certain footwear classified in Chapter 64 of the Harmonized Tariff Schedule (HTS) eligible for duty-free treatment under the GSP. If the bill passes, it may provide additional opportunities for US importers to cut costs by migrating current footwear manufacturing to GSP-eligible countries. On 31 October 2017, the American Apparel & Footwear Association (AAFA) endorsed[30] the bill, explaining that an expansion of the GSP will support and help grow American jobs.

Implications for importers

Following the GSP's last expiration in 2013 and its subsequent reinstatement in 2015 (H.R. 1295), importers were able to retroactively claim GSP duty refunds by filing a request for liquidation or re-liquidation. In preparation for the GSP's upcoming expiration, US Customs and Border Protection (CBP) has issued a Cargo System Messaging Service (CSMS) notification[31] advising importers to keep flagging GSP-eligible importations with the applicable A, A+ or A* SPI (special program indicator) code. After the GSP expires, goods entered with the applicable SPI will be liable for column 1 general duty rates. However, once the GSP is renewed, CBP plans to enable an automated duty refund to all Automated Broker Interface (ABI) filers that flagged their importations with the appropriate GSP SPI. CBP will also continue to allow post-importation GSP claims through post-summary corrections (PSCs) after the expiration of the GSP on all goods entered prior to the expiration date.

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[28] USTR Announcement available at: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/october/ustr-announces-new-enforcement.

[29] S. 2032 — 115th Congress: GSP Footwear Act of 2017, https://www.congress.gov/bill/115th-congress/house-bill/2735/text.

[30] https://www.aafaglobal.org/AAFA/AAFA_News/2017_Press_Releases/AAFA_Applauds_Launch_of_GSP_Footwear_Bill_Urges_Congress_to_Renew_Overall_GSP_Program_ASAP.

[31] CSMS #17-000622 is available at: https://apps.cbp.gov/csms/viewmssg.asp?Recid=23021&page=&srch_argv=17-000622&srchtype=all&btype=&sortby=&sby=.

Moreover, in anticipation of the expiration, importers benefitting from the GSP can modify their time of entry to ensure duty-free entry. As per 19 CFR 141.68(a)(2) and (3), time of entry can be as early as entry documentation is filed, provided the merchandise has arrived within the port limits. If importers anticipate GSP-eligible goods to arrive in close proximity to the deadline, they may wish to take appropriate measures to ensure timely filing.

Finally, close attention to the other developments related to the GSP will enable importers to detect in a timely manner changes that may affect their operations.

Look for updates in future issues of *TradeWatch*.

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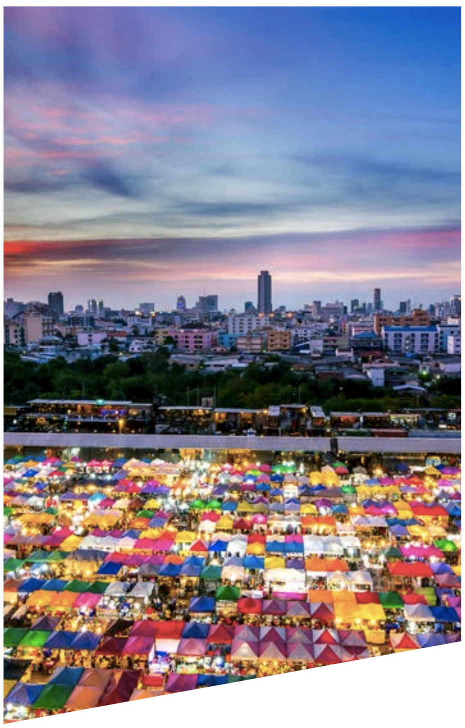
India

CBEC prescribes guidelines for claiming refund of IGST paid on export of goods



India's Central Board of Excise and Customs (CBEC) has issued an internal instruction dated 9 October 2017[32] to facilitate the processing of refund claims.

The instruction addresses refund claims made by exporters for Integrated Goods and Services Tax (IGST) paid on the export of goods. Key takeaways from the instruction are as follows:

- The refund process for goods exported in the month of July 2017 started 10 October 2017.
- Refunds for subsequent months will commence once a separate utility for filing export details as per Table 6A of Form GSTR-1 has been developed.
- The shipping bill and bill of export will be treated as a refund claim.
- Filing of Form GSTR-3 or Form GSTR-3B is essential for initiating the refund process.
- Refunds will be credited electronically to the exporter's bank account mentioned in registration particulars and as communicated to the customs authority.

Background

After the Goods and Services Tax (GST) was introduced effective 1 July 2017, compliance procedures for the export of goods and refund of IGST paid on such export have been a matter of concern of the exporters.

Rule 96 of the Central GST Rules provides that the shipping bill filed by an exporter shall be deemed to be an application for refund of the IGST paid on exported goods once the Export General Manifest and valid return in Form GSTR-3 or Form GSTR-3B have been filed.

Taking into account the difficulties in processing refund claims, the GST Council (the Council) established the Committee on Exports. The committee's recommendation to commence refunds for exports pertaining to July 2017 by 10 October 2017 was endorsed by the Council during its meeting on 6 October 2017. Instructions have been accordingly issued in this matter.

[32] Instruction No. 15/2017-Customs, dated 9 October 2017.

Refund procedure

Export General Manifest (EGM)

- Filing of a correct EGM by the airlines, shipping lines or carriers is an important step in treating the shipping bill or bill of export as a refund claim.
- Exporters are advised to follow up with their carriers to ensure that a correct EGM and export reports are filed in a timely manner.

Details of export supplies in Table 6A of Form GSTR-1

- The exporter has to fill the invoice details of the exports made in Table 6A of Form GSTR-1. These details are matched electronically with the details available with the customs authority that were provided in the shipping bill/bill of export. The details available in the customs system have been made available for viewing in the IceGate (Indian Customs Electronic Commerce/Electronic Data Interchange Gateway) login.
- As Form GSTR-1 for the month of August 2017 and subsequent months cannot be filed at present, a separate utility for filing details in Table 6A of Form GSTR-1 will be made available to facilitate the processing of refunds.

Filing of Form GSTR-3 or Form GSTR-3B

As filing a valid return in Form GSTR-3 or Form GSTR-3B is another precondition for the granting of refunds, exporters must file these returns expeditiously.

Bank account details

- The refund claim shall be credited to the bank account of the exporter registered with customs even if it is different from the bank account of the applicant mentioned in the registration details.
- Exporters may either change the bank account declared to customs to align it with their GST registration details or add the account registered with customs in their GST registration details.
- As refund payments are routed through the Public Finance Management System (PFMS) portal, exporters must get the bank account details validated by PFMS.

Withholding of refund

If the refund amount is required to be withheld in accordance with the provisions of the GST Act or Customs Act, the proper officer of integrated tax at the customs station has to communicate the withholding of refund to the applicant.

Guidelines and procedures for the filing and processing of refunds of IGST paid on exports done under manual (non-EDI) shipping bills shall be communicated separately.

Implications

Steps taken by the Government of India will provide needed relief to exporters that paid IGST at the time of the export of goods but could not claim a refund due to system issues.

The Government is expected to also issue similar instructions for granting refunds to exporters that have exported goods or services under a Bond/Letter of Undertaking or exported services by paying IGST.

Online processing of refunds with electronic cross-matching of information with customs is expected to reduce paperwork and expedite the granting of refunds.

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Japan

Customs annual report on post-entry audits for 2017

The Ministry of Finance recently released its annual report on post-entry customs audits. The data released indicates that customs audits continue to be conducted at high frequency and have become even more stringent compared to the previous year, as evidenced by a steady increase in the number of audits performed and a sharp increase in the amounts assessed.

The number of audited entities increased from 4,302 to 4,325, and the percentage of entities subject to assessments rose 11%, from 2,977 to 3,307. The amount of assessments (additional customs duties and import consumption taxes) also increased by 41%. Administrative penalties for negligence and gross negligence also doubled.

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

Three out of the five categories (meat, electrical equipment, and machinery and mechanical appliances) have continually made the list for the past four fiscal years. Optical instruments and apparatus have appeared consecutively, while footwear has returned back to the list. The amount of duty shortfall for the meat category tripled from the previous year, with an increase of JPY3.24 billion, topping the list.

The most commonly cited customs violation cases are described below. In particular, abuse of the gate price system for imported pork (i.e., intentionally declaring a fraudulent unit price for pork to obtain a lower customs duty rate) has been included in the top five commonly cited customs violations continually for the past four years.

Items and Harmonized Schedule (HS) code	Duty/tax shortfall
1. Meat (Chapter 02)	JPY5.00 billion
2. Electrical equipment (Chapter 85)	JPY2.58 billion
3. Footwear (Chapter 64)	JPY1.66 billion
4. Optical instruments and apparatus (Chapter 90)	JPY1.39 billion
5. Machinery and mechanical appliances (Chapter 84)	JPY1.18 billion

Case 1: Failure to report retroactive transfer pricing adjustments

An importer purchased medical equipment from a number of countries, including the United States. Based on an agreement with the seller, the transfer price was adjusted retroactively, and the importer paid the difference. However, the importer failed to file amended declarations to reflect the additional payment in the import price.

As a result, the importer was found to have under-declared the import value by JPY6.19 billion and was assessed an additional JPY496 million in import taxes and penalties.

Case 2: Overvaluation of frozen pork meat

An importer imported US origin frozen pork from a Taiwan exporter. The importer declared that it purchased the pork at a price of approximatelyJPY524/kg, which resulted in the lowest customs duty amount under the gate system. However, the importer's actual purchase price, which was much lower than the declared value, should have been declared instead.

As a result, the importer was found to have over-declared the import value by JPY4.97 billion and was assessed an additional JPY6.71 billion in import tax and penalties (including a penalty of JPY1.74 billion for gross negligence).

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

An importer of parts used to manufacture Pachinko machines (a vertical pinball-like machine) provided materials necessary to manufacture the parts to manufacturers in China free of charge. The importer should have included the cost of such materials in the import price but failed to do so.

As a result, the importer was found to have under-declared the import value by JPY2.09 billion and was assessed an additional JPY130 million in import tax and penalties.

Case 4: Failure to report royalty of the imported goods

An importer imported bags from a Hong Kong exporter. The exporter concluded a license agreement with the licensor of the trademark related to the imported bags, and the importer made royalty payments to this licensor. The importer should have included the royalty payment in the import price but failed to do so.

As a result, the importer was found to have under-declared the import value by JPY758 million and was assessed an additional JPY12 million in import taxes and penalties.

Case 5: Import declarations based on falsified invoices

An importer imported hats from various countries, including Vietnam. The importer was aware of the actual price before import but requested the exporter to prepare invoices with a lower price and declared the customs value based on these false invoices in an attempt to conceal the real transaction value.

As a result, the importer was found to have under-declared the import value by JPY119 million and was assessed an additional JPY12 million in import taxes and penalties (including a penalty for gross negligence).

Stakes for noncompliance are high

Since 1 January 2017, a penalty of 5% is imposed on underpayment of import taxes even if the importer voluntarily discloses this after the issuance of an impending post-entry customs audit but prior to the commencement of the actual audit. While this is still lower than the 10% to 15% penalty imposed on underpaid taxes found during the audit, this new rule serves to deal with importers that neglect to make proper declarations on an entry-by-entry basis and make voluntary disclosure just prior to the audit to avoid paying penalties. Under this new rule, repeat offenders will be subjected to additional penalties. If the importer has been cited for non-declaration or fraud/gross negligence within the past five years, an additional 10% penalty will be imposed.

Focus on customs value

In Japan, many of the goods included in the top five categories of products subject to assessments are duty-free, including many items of Chapters 84, 85 and 90. However, custom value is also the basis of import consumption tax, which is levied on all imported goods regardless of the custom classification.

For this reason, customs closely scrutinizes imports made by such importers to ensure that they declare correct customs value in compliance with relevant custom laws and regulations.

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

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

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New Zealand

New customs and excise legislation for New Zealand

The New Zealand Customs Service (NZCS) embarked in 2013 on the process of reviewing and modernizing the current customs and excise legislation, the Customs and Excise Act 1996 (the Act).

With the current legislation being 20 years old, the review was long overdue, as the current Act is too prescriptive and often difficult to follow.

After several years of consultation and extensive stakeholder feedback,[33] the Customs and Excise Bill 2016 (the Bill) was introduced to Parliament in November 2016.[34] The introduction of the Bill was a major step forward, as, among other matters, this would ensure that customs and traders would have a modern and flexible framework in which they could operate.

A complete overhaul of the rules

The Bill has resulted in a myriad of changes to the current framework — everything from the movement of international passengers to information-sharing provisions.

We have summarized below some of the substantial changes to the current Act, in particular, the Bill:

1. Streamlines the Goods and Services Tax (GST)
2. Allows importers to declare a provisional value for goods in specific circumstances and declare a final value later
3. Enables NZCS to issue binding valuation rulings
4. Introduces Inland Revenue Department-style compensatory interest and late payment penalties

Date of enactment

The majority of the Bill as drafted is intended to come into force on 1 April 2018.[35] We understand that officials are now aiming for a 1 July 2018 implementation date.

While the amended Act is not anticipated to come into force until mid-2018, importers need to start assessing the impact of the new Bill on their businesses, if they have not done so already.

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33 See "The new Customs & Excise Act: bill to be introduced soon" in the September 2016 issue of *TradeWatch*, where we discuss some of the changes that were being proposed at the time.

34 The text of the Customs and Excise Bill 2016 is available at: www.legislation.govt.nz/bill/government/2016/0209/latest/096be8ed8157c7d0.pdf.

35 Clause 2, Customs and Excise Bill 2016.

Streamlining of Goods and Services Tax

Pursuant to the Goods and Services Tax Act 1985 (GST Act), generally, goods that are imported into New Zealand are subject to GST at the standard rate of 15%.[36]

For customs purposes, as import GST is within the definition of "duty," customs collects import GST at the border.[37] This was a deliberate design choice made in 1985 to ensure that the integrity of the New Zealand tax system is maintained, in particular to minimize revenue risk of goods entering New Zealand without paying GST.

While GST is payable at the border, importers that are GST-registered and use the imported goods in the course of making taxable supplies (i.e., for business use) may claim GST refund from Inland Revenue when they file their GST returns.[38]

Given the administrative inefficiencies created, as part of the initial review of the customs and excise legislation, customs considered four options for streamlining GST:

- Remove GST from imported goods
- Remove GST as a duty and apply as a tax
- Introduce zero-rated GST for registered importers

Or

- Adopt the Australian GST deferral approach[39]

Despite stakeholder feedback for change and customs acknowledgement that there are opportunities for more efficiency, there was no legislative solution in the Bill.

Customs has indicated that if a suitable cost-effective solution can be identified, this will be outlined in a discussion document in late 2017. We are hopeful that the Australian GST deferral approach would be adopted.

Introduction of provisional value regime

The Bill has introduced a new regime where importers are able to declare a provisional value for goods in specific circumstances and declare a final value later.[40]

There is limited eligibility to register for the program.[41] Eligibility is limited to the following situations:

- Where the importer has an advance pricing agreement (APA) with the New Zealand Inland Revenue
- Where the value of goods is determined under the transaction value method but is subject to adjustments because of royalties and license fees or additions of proceeds due to the seller, and such adjustments cannot be made because of insufficient information (defined term)[42]
- At the Chief Executive's discretion

It is apparent that the regime will provide preferential treatment for those importers that have an APA with the New Zealand Inland Revenue.

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36 Section 12, Goods and Services Tax Act 1985.

37 Section 2, Customs and Excise Act 1996.

38 Section 20(3), Goods and Services Tax Act 1985.

39 The Australian GST deferral approach permits importers to defer the payment of GST on taxable importations and include the GST in the GST return following importation. The effect of the deferral regime is that importers are not required to pay import GST to the Australian authorities.

40 Clause 102, Customs and Excise Bill 2016.

41 See Clause 102(1).

42 Pursuant to Clause 2, Schedule 4 of the Bill, sufficient information is defined as "in respect of the determination of any amount, difference, or adjustment, means objective and quantifiable information that clearly establishes the accuracy of the amount, difference, or adjustment."

Unless the value of goods is determined according to the transaction value method as outlined above (which is a formalization of the current uplift program), an importer without an APA will need to rely on a more general provision where the Chief Executive may exercise her discretion. Importers should be aware that before the Chief Executive will exercise her discretion, in the event the adjustment relates to a transfer pricing arrangement, the Chief Executive must consult the Commissioner of the Inland Revenue in relation to the appropriateness of the transfer pricing arrangement.[43]

The new legislation appears to create an implicit bias toward those importers that do not have an APA. It will be important that importers have their transfer pricing documentation up to date in order to avoid unnecessary scrutiny from the authorities.

Why should importers enroll in the regime?

Importers could be exposed to new compensatory interest and late payment penalties if they are not enrolled in the regime and there is a change in the value of the goods (e.g., as a result of transfer pricing adjustment). We have outlined in detail below this new regime.

Extending the scope of binding valuation rulings

Under the current Act, NZCS is only able to issue binding rulings on the origin of a good, tariff or excise classification, or whether a good is subject to a duty concession.[44]

The Bill now provides for traders to obtain binding valuation rulings according to the methods outlined in Schedule 4 of the Bill.[45] A valuation ruling may be sought on:

- The appropriate valuation method to use in a particular situation
- The interpretation of a particular clause or word in Schedule 4

The objective of valuation rulings is to provide applicants with legal certainty about customs' view of the correct valuation method to use and how much duty they need to pay on their goods.

While we expect that there will be uptake on the ruling process, there are some impediments that may impact the process, as outlined below.

How long is a ruling valid?

Generally, a binding ruling will be valid for three years after the date on which customs has issued the ruling.[46]

Traders will need to be aware of the circumstances in which a ruling is obtained, as any material changes to the background information will impact the validity of the ruling.

How long does it take to obtain a valuation ruling?

The maximum legislative time frame for issuing a valuation ruling is 150 days.[47] Early indications suggest that customs will seek to take full advantage of this time frame. As a result, obtaining a ruling will not likely be a fast process.

How much does it cost?

We understand that customs intends to impose a full cost recovery mechanism for obtaining a valuation ruling. To achieve this, customs will charge an hourly cost recovery fee in addition to an application fee.

While customs will provide an indicative fee upon applying for a ruling, we expect that applications for rulings may become quite expensive. Cost may be a major deterrent for traders in obtaining such rulings.

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[43] Clause 102(8A), Customs and Excise Bill 2016.

[44] Section 119, Customs and Excise Act 1996.

[45] Clause 310(2), Customs and Excise Bill 2016; the methods of valuation prescribed under Schedule 4 follow the World Trade Organization Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994.

[46] Clause 320, Customs and Excise Bill 2016.

[47] Ibid., Clause 313(3).

Introduction of interest and penalties

The current Act employs a wide range of potential sanctions to address noncompliance. Under the current Act, where duty (defined term) remains unpaid by the due date, additional duty of 5% is imposed and a further 2% is imposed for each month after that on a compounding basis.[48]

The new Bill has replaced the additional duty regime and instead has adopted Inland Revenue-style interest and penalties, compensatory interest and late payment penalties.

Compensatory interest

The legislative intent behind compensatory interest is to compensate the Crown for loss of revenue.

Compensatory interest will apply to importers using the deferred payment scheme and to excise clients.[49] It is charged whenever duty is underpaid. This includes late payments, shortfall payments, and incorrect refunds and drawbacks.

The compensatory interest rate will be equivalent to the Inland Revenue use of money interest, which is currently 8.22%.

Late payment penalties

The legislative intent behind late payment penalties is to deter and penalize noncompliant behavior that leads to late payments.

Late payment penalties will be applied as follows:[50]

- One percent of the outstanding duty will be charged on the first day after the due date.
- A further penalty of 4% of any duty still outstanding will be charged on the seventh day after the due date.

After the seventh day, no further penalties will be applied, and only compensatory interest will continue to accrue. In the event payment is still not received, the authorities will consider alternative interventions.

Remissions and cancellations

The Bill and regulations will provide for limited grounds for remission or cancellation of compensatory interest and late payment penalties.

The grounds for remitting compensatory interest are more limited than those for remitting late payment penalties. The legislative intent behind compensatory interest is to compensate the Crown for loss of revenue, rather than to penalize noncompliance.

Remissions may occur in the following circumstances:[51]

- Interest – remissions and refunds for emergency events
- Interest – inadvertent error by duty payer
- Penalties – remissions and refunds where reasonable excuse for late payment of duty
- Penalties – remissions and refunds for good payment record

48 Section 87, Customs and Excise Act 1996.

49 Clause 154A, Customs and Excise Bill 2016.

50 Clause 154F, Customs and Excise Bill 2016.

51 Clause 154L to 154Q, Customs and Excise Bill 2016.

- Interest and penalties – remissions and refunds if duty determined not to be payable
- Interest and penalties – remissions and refunds if consistent with collection of highest net revenue over time

While there is a wide range of situations in which interest may be remitted, it will not be fully remitted in every case. For example, interest will only be partially remitted to the 90-day bank bill rate (currently 1.94%) where the error is an inadvertent error.

Closing thoughts

While the modernization of customs legislation is a positive step forward to support trade in New Zealand, there are significant changes that will impact traders that currently interact with the NZCS. Thus, despite an anticipated implementation date of 1 July 2018, traders need to consider as soon as possible how the new framework will impact their businesses.

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Thailand

New excise tax laws in Thailand

With effect from 16 September 2017, the new Excise Act B.E. 2560 (2017) replaces the former Excise Act B.E. 2527 (1984). The new excise laws implement excise tax reforms aimed at improving the excise tax structure; harmonizing excise laws with the current economy and Thai society; enhancing the fairness, transparency and efficiency of excise tax collection; and consolidating various excise tax-related laws under a single legislation.

To implement the new Excise Act, on 16 September 2017, the Ministry of Finance released 39 new ministerial regulations and the Excise Department released 45 new excise notifications. Some of the key changes under the new excise tax regime are detailed below.

1) Changes to scope of excisable goods, tax structure and tax rates

Beverages

- Coffee, tea, fruit juice and vegetable juice are generally subject to both ad valorem and specific tax rates, where applicable.
- For fruit juice and vegetable juice, exemption on payment of the ad valorem tax rate shall apply if it meets the juice content specifications set by the Director-General (DG) of the Excise Department.
- Syrup used for producing ready-to-drink beverages using machines for sale at retail points is also caught and subject to a specific tax rate.
- Birds' nest beverages[52] are classified as beverages by DG and subject to both ad valorem and specific tax rates.
- To reduce consumption of sugar, a specific tax rate structure is used to impose excise tax on beverages with sugar added, with the tax rates to increase at two-year intervals until October 2023.
- Effective from 1 November 2017, the scope of excisable goods was further expanded to include beverage products in powder or flake form or concentrate beverages containing sugar and dissolvable in water. Food supplements and milk products in powder form, as covered under any food laws, is however exempted.

[52] Specialty beverages made from the edible nests of cave-dwelling swiftlet birds.

Alcoholic beverages

- Generally, ad valorem rates have been reduced while specific rates have been increased.
- In addition, the threshold for the two-tier ad valorem rate structure was increased from THB600 (approximately USD18) of the last wholesale price (LWP) to THB1,000 (approximately USD30) of the suggested retail price (SRP) for wines.

Tobacco

- A two-tier ad valorem rate structure (20% vs. 40%) on cigarettes was introduced for a two-year period, depending on whether the SRP exceeds the threshold of THB60 (approximately USD1.8) per pack of 20 cigarettes. Both rates will be aligned at 40% effective as of 1 October 2019.
- Unlike under the old excise law, tobacco products will now also be subject to both ad valorem and specific rates.
- In addition, municipal tax of 10% of the excise tax amount will be payable.

Passenger vehicles, motorbikes, perfumes, cosmetics and batteries

- Ad valorem rates have been reduced because of the change in the excise valuation basis to SRP.

Excisable goods with excise tax rate reduced to 0%

Due to the high administrative costs and minimal overall contribution to the Excise Department's tax revenue collection, the applied tax rates for the following excisable goods have been reduced to 0%:

- Lighting and chandeliers for ceiling or wall, excluding those for public open spaces or public roads
- Lead crystal and other types of crystal
- Yachts and boats used for leisure purpose
- Carpets and other floor covering textiles
- Marble and granite

2) Suggested retail price

- To harmonize and establish a transparent valuation basis under the new excise regime, all imported and locally produced excisable goods subject to an ad valorem tax rate will be valued based on the SRP. The main differences between the old valuation basis and the new can be summarized as follows.

Old excise law	New excise law
Tax base: 1) **For alcoholic beverages: LWP** LWP refers to the price at which a licensed alcoholic beverages producer or importer, or approved alcoholic beverages seller, sold alcoholic beverages to a retailer, including transportation costs or other service fees. The LWP must be a frank and open price concluded in the normal course of business, excluding value-added tax (VAT). 2) **For all other excisable goods:** i) Locally manufactured goods: Value = Ex-factory price ii) Imported goods: Value = CIF (cost, insurance and freight) + duty (if any) Tax calculation basis: 1) **For alcoholic beverages:** **= LWP x Applied ad valorem rate** 2) **For all other excisable goods, the tax calculation varies as follows:** i) For goods subject to municipal tax: = Value x Applied ad valorem rate 1 – (1.1 x Applied ad valorem rate) ii) For goods not subject to municipal tax: = Value x Applied ad valorem rate 1 – Applied ad valorem rate	Tax base: **For all excisable goods: SRP** SRP is the price at which an industrial operator or importer generally wishes a product to be resold to consumers, excluding VAT. In principle, SRP must not be lower than the selling price to end consumers in an open market. Tax calculation basis: For all excisable goods: = SRP x Applied ad valorem rate

Under the new SRP regime, taxpayers are required to notify the DG of the SRP of the excisable goods for verification prior to the importation or removal of the excisable goods from the excise-registered premises. The SRP notified by a taxpayer is subject to verification by the DG as follows:

i) If the selling price has been widely communicated to consumers, the verification is based on:
   - The sale price that appears on the goods
   - The sale price that appears on any printed publication or electronic media channel
   - The sale price that appears on the price list
   - The sale price that has been reported to government organizations or agencies

ii) In cases where a list of retailers that receive goods from the taxpayer for further sale to general consumers is submitted, the DG will verify the SRP with the listed retailers and the SRP obtained from these retailers shall be deemed the SRP of the taxpayer. If several SRPs are obtained, the highest SRP is applied.

The SRP notified to the DG is to be determined based on the costs of production, administrative costs and standard profit, excluding VAT. Taxpayers are required to provide a breakdown of the SRP for each product as follows:

a) Costs of production
   - For goods manufactured in Thailand: the whole cost of production of the goods, including costs of raw materials, labor costs and other expenses for production
   - For imported goods: the price of the goods and expenses related to importation of the goods into Thailand, such as CIF price, customs duty and other expenses related to import formalities

b) Administrative costs determined on the basis of office-related expenses, such as advertisement costs, transportation costs, insurance costs, excise tax, other taxes and charges levied in relation to the sale of the goods, fees for storage under customs custody, fees attributed to funds or organizations lawfully collectible from the taxpayer of such goods, and other expenses related to sales management of the local manufacturer or importer

c) Standard profit determined on the basis of SRP minus costs of production and administrative costs

d) SRP (excluding VAT)

Circumstances	Basis for determining SRP
1) SRP notified to the DG is deemed inconsistent with reality under any one of the following circumstances: i) SRP notified is lower than 95% of mode price[53] of such goods. ii) There is no mode price and SRP notified is lower than 85% of highest retail price of such goods in a normal market.	**Method 1** SRP to be based on either of the following, provided that it excludes VAT and neither price is a price for sales promotion purposes, net of discounts, or includes other added benefits: 1.1 Mode price Or 1.2 If there is no mode price, the highest retail price in a normal market
2) SRP notified to the DG is deemed not to follow a market mechanism under any one of the following circumstances: i) The price is not the price at which goods are actually sold between the taxpayer and consumers. ii) The price is for sales promotion purposes. iii) The selling price is the price at which goods are sold to those with special privileges. iv) The selling price is conditional, causing the price not to follow a market mechanism.	**Method 1 (as above)** **Method 2** 2.1 Local manufacturer's selling price + administrative costs + standard profit until the retail sale of the goods to consumers, excluding VAT 2.2 Customs price + administrative costs + standard profit until the retail sale of the goods to consumers, excluding VAT **Method 3** 3.1 SRP of an identical or similar type, kind, quality and quantity of goods that the taxpayer sells in the market to consumers Or 3.2 SRP of an identical or similar type, kind, quality and quantity of goods that another taxpayer sells in the market to consumers
3) SRP cannot be determined.	Method 2 or Method 3 shall apply, mutatis mutandis.

[53] "Mode price" refers to retail price (excluding VAT) that is found most often in the normal market of such goods and that is of the same type, kind, quality and quantity, as surveyed by the Excise Department during the same period.

3) Key changes in excise tax provisions

Issue	Old excise law	New excise law
Missing goods or raw materials essential to production of excisable goods	Not specified	▸ Excise tax liability is triggered at the time they go missing or are found missing. ▸ 200% penalty + 1.5% monthly surcharge (capped at 100%) applies. Exception: Force majeure, or good faith error in counting that was an unintentional or negligent act of a local manufacturer
Assessment period	▸ 2 years (if return is filed) Or ▸ 10 years (if return not filed or tax underpaid by > 25%)	▸ 2 years, but extendible to 5 years with DG's approval if there are reasonable grounds to believe that the taxpayer filed an incorrect or incomplete tax return ▸ No change to 10-year period
Penalty for excise tax short payment	100% of excise tax short paid	▸ Generally, 100% of excise tax short paid ▸ 200% of excise tax short paid if amount short paid > 25% of excise tax payable
Time to file appeal against assessment	45 days from date of receipt of assessment	30 days from date of receipt of assessment
Time for appeal committee's consideration	Not specified	180 days from the date of receipt of complete evidential documents; may be further extended not more than 90 days
Excise registration for importer of excisable goods	Required for selected excisable goods	Required for all excisable goods
Prescribed goods eligible for excise tax relief where excise tax paid on raw materials can be deducted from excise tax payable on finished goods	▸ Petroleum ▸ Beverages ▸ Batteries ▸ Motor vehicles ▸ Motorcycles ▸ Alcoholic beverages	Additional prescribed goods include: ▸ Perfumes and fragrance essence ▸ Cosmetics ▸ Tobacco
Valuation basis on goods for determining fines in the event of settlement case	Value of goods of the same kind or similar goods shall be used	▸ SRP ▸ If no SRP, then the value of same or similar kind of goods, on which tax has been correctly paid at or about the time of the commission of the offense Or ▸ If none of the above applies, or there are several prices, the DG has power to announce the value of the goods

4) Excise's revised prescribed fees

No.	Old excise law	Unit	Applied fees (THB)[54]	Ceiling fees (THB)
1.	A license to establish a bonded warehouse	Per application	60,000	150,000
2.	Annual fee for a bonded warehouse	Per annum	6,000	15,000
3.	A registration of tax payment mark	Each unique character	3,000	7,500
4.	A license to produce a registered tax payment mark	Per application	150,000	150,000
5.	A license renewal under (4)	Per application	150,000	150,000
6.	A license to import a registered tax payment mark	Each	1,500	5,000
7.	Control of the production of a registered tax payment mark	Per month	30,000	75,000
8.	A license to produce alcoholic beverages	Per application	1,800-60,000	300,000
9.	A license to import alcoholic beverages	Each	300-1,200	25,000
10.	A license to sell alcoholic beverages: ▸ Type 1 ▸ Type 2	 Per annum Per annum	 600-5,000 300-2,000	 100,000 50,000
11.	A license to produce tobacco	Per application	330-150,000	300,000
12.	A license to sell tobacco: ▸ Type 1 ▸ Type 2 ▸ Type 3	 Per annum Per annum Per annum	 100-1,200 100-500 1,200	 100,000 50,000 100,000
13.	A license to purchase dried tobacco leaf	Per application	15,000	30,000
14.	A license to import or export tobacco leaf, pressed tobacco or cigarettes into and out of Thailand	Each	300	25,000
15.	A license to produce playing cards	Per application	150,000	300,000
16.	A license to sell playing cards: ▸ Type 1 ▸ Type 2	 Per annum Per annum	 1,200 100-500	 100,000 50,000
17.	A license to import playing cards into Thailand	Per application	300	25,000
18.	Substitute for license	Per application	Half of the license fee for that license type, but not more than 100	1,000
19.	The transfer of a license	Half of the license fee for that license type		

[54] As a guide, THB1,000 equals approximately USD30.22.

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European Union

Update on the EU excise duty scrutiny in relation to the customs tariff classification of aromatic heavy oil

In the June 2017 issue of *TradeWatch*, we outlined the EU customs authorities' intensified audit activities in relation to the customs tariff classification of energy products, such as aromatic heavy fuel oil. This has led to significant challenges for companies doing business with energy products in the EU.

Since June 2017, the customs authorities appear to have increased their audit efforts in this area even further.

Background

For many years, importers have used heading 2710 of the Combined Nomenclature (CN) for the classification of most fuel oils based on sulfur content. However, following the European Court of Justice (ECJ) case[55] on the classification of fuel oils, it is possible that such classification may be incorrect if the fuel oils have an aromatic content that is higher than 50%. As a result of the ECJ ruling, customs authorities in various EU Member States, such as Belgium and the Netherlands, have started demanding classification under subheading 2707.99.99 instead of heading 2710 when analyses of imported fuel oils show an aromatic content higher than 50%.

Fuel oils classified under subheading 2707.99.99 instead of heading 2710 may not be shipped under suspension of excise duties with an electronic Administrative Document (e-AD) via the Excise Movement and Control System (EMCS). Instead, companies dealing with this type of goods will need to consider an alternative excise duty arrangement.

The customs tariff classification of these type of products was addressed by the World Customs Organization (WCO) Harmonized System Committee in September. The Harmonized System Committee has confirmed that classification under heading 2710 is appropriate irrespective of the aromatic content. Nevertheless, the ECJ decision remains in effect in the EU. It is possible that the Harmonized System Committee may alter the language in the Harmonized System, likely by the addition of a chapter note, to effectively supersede the ECJ decision. But, any such changes would go into effect only with the next revision of the Harmonized System in 2022.

[55] European Court of Justice (ECJ) Case C-330/13 dated 12 June 2014.

Business challenges

Although fuel oils classified under 2707 cannot be shipped under suspension of excise duties with an e-AD via the EMCS, these products are excisable in the UK. Therefore, importers need to account for excise duty at the prevailing rate prior to removal from the storage facilities in the load port.

Importers may claim refunds of excise duty in the UK based on evidence that the fuel oils have been received in another EU Member State and excise duty in that Member State has been secured and accounted for. This has implications from a cash perspective. In terms of real cash, a refund may not be available for any losses incurred between the load and discharge ports. From a cash flow perspective, there are timing differences between accounting for any excise duty in the Member State where the product is loaded and gaining a refund following the receipt of the excise duty.

There have been excise duty assessments raised in certain Member States, such as the Netherlands, where fuel oils have been shipped from another EU Member State (e.g., Germany) under an e-AD. The authorities may test the fuel oils on discharge to establish whether the aromatic content is higher than 50%.

Additionally, tax warehouses in various destination countries have been refusing to accept fuel oils classified under heading 2707 where the facility is not approved to receive fuel oils classified under this heading. On occasion, these warehouses may request that the product is reclassified under heading 2710.

Changes to the Harmonized System effective after 2022 could provide long-term relief, but not for several years. In the meantime, companies that trade in energy products in the EU will need to review the accuracy of the customs tariff classification of their products to be able to proactively manage these practical challenges.

Look for updates in future issues of Trade Watch.

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Ghana

Ghana discontinues requirement for up-front payment of import duties and taxes on exempt imports

Ghana's Deputy Minister of Finance and Economic Planning, Mr. Kwaku Kwarteng, has announced that the Government will discontinue the requirement for up-front duty payments on imported goods that are exempt from tax. The Deputy Minister announced this decision to the general public at a meeting with journalists in Accra.[56] This new directive is in effect as of 1 October 2017.

Previously, importers were required to pay duty upon the importation of exempt goods and subsequently file for refund. This measure was instituted in April 2017 to prevent abuses of the exemption regime. According to the Deputy Minister, as a result of stakeholder consultations, the Government will now deal with abuses in ways that are less burdensome to importers that will now need to meet certain requirements to benefit from the exemptions.

Importers will be required to provide documentation, including, among others:

- The basis for the exemption
- A recommendation letter from the relevant sector ministry or agency
- The Customs Classification and Valuation Report (CCVR) or customs declaration form
- The import declaration form
- The tax clearance certificate
- The bill of lading
- Any commercial invoices
- The packing list
- A tax exemption assessment report

Companies that import goods into Ghana will first need to assess whether their goods qualify for duty exemption. If so, they need to obtain and submit the necessary documentation to substantiate duty exemption eligibility before they may take advantage of this opportunity to reduce costs.

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[56] See *Business News of Tuesday, 19 September 2017*, available at: http://citibusinessnews.com/index.php/2017/09/19/govt-reviews-policy-on-tax-exemptions/.

Ghana Revenue Authority issues new guidelines on export and re-export of petroleum products

The Commissioner-General (C-G) of the Ghana Revenue Authority (the GRA) has issued new guidelines for the export and re-export of petroleum products to curb the recent hike in smuggling and abuses and to prevent further losses in revenue. The guidelines are in effect as of 20 October 2017.

Following recent incidents of smuggling at the Ghanaian ports and storage depots, the C-G of the GRA has issued the following guidelines for export and re-export of petroleum products to stem abuses and to prevent further loss of revenue. Petroleum service providers (PSPs) are required to follow the provisions set forth in the guidelines for the documentation and removal of their consignment at the ports.

The guidelines are as follows:

1. Obtain an export license from the National Petroleum Authority (NPA) to qualify to lift petroleum products for export or re-export from any storage depot in the country.
2. Apply to the C-G to be registered as a self-declarant for customs documentation.
3. Obtain a removal bond from an insurance company. To procure the bond, the person must first apply to the C-G for an estimate of the bond sum.
    - The application shall include information on the type of product and corresponding quantity intended for export or re-export over a 90-day period and the country of destination.
    - Upon the approval of the bond sum, the application is forwarded to an insurance company for the issuance of the bond.
    - Subsequently, the bond is submitted to the C-G for authentication through the Assistant Commissioner for Petroleum, Customs Division of the GRA.
4. After the bond is authenticated, a signed copy is submitted to the Sector Commander at Tema Oil Refinery or Bolgatanga.
5. Bulk road vehicles (BRVs) are to be registered with the Petroleum Regulator of their respective country and a copy submitted to the Ghana NPA for inspection and authentication. The Chamber of Commerce of the receiving countries located in Ghana shall also provide to the Assistant Commissioner for Petroleum, Customs Division of the GRA a list of all registered BRVs authorized to transport petroleum products from Ghana.

Further, all BRVs are to be covered with temporary vehicle importation (TVI) declarations. The TVIs are to be submitted to the designated loading points of Customs Division together with the collection orders for approval before loading. Customs shall seal the loaded BRV after loading. Where an external agency has been contracted to seal the loaded trucks, its seal shall be an addition to the customs seal.

6. The exporter is required to prepare export documents to cover BRVs and quantity loaded as follows:
   - Certificate of Origin (for direct export)
   - Customs declaration forms
   - Customs appendix forms (giving details of each BRV)
   - Invoice from PSP for export
   - Sales purchase agreement or evidence of payment
7. The exporter is also required to submit the customs declaration with all the attachments to the customs officer-in-charge of the depot for processing. Further, the exporter is required to obtain from customs a hard copy of the details of all the trucks conveying the consignment before final dispatch. These details shall include the particulars of the truck, as well as its respective loaded capacities, and the numbers of all the attached customs seals.
8. At the intermediate checkpoints, customs officers are required to conduct external examination to ensure that all seals are intact. The checking officer shall record his findings on the Ghana Customs Management System (GCMS) workstation and in a customs register designed for the purpose.
9. At the exit point, officers shall apply controls and ensure that the BRVs exit with the product intact and report their observations as internal remarks in the GCMS and subsequently close the transaction.

According to the GRA, the guidelines will be strictly enforced, and any deviation from the guidelines may be penalized under existing legislation. The guidelines are in effect as of 20 October 2017.

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Kazakhstan

Kazakhstan's new Customs Code

On 11 April 2017, the Presidents of the Eurasian Economic Union (EAEU) Member States signed the Treaty on the Customs Code of the EAEU (EAEU Customs Code), which is currently in the process of ratification by the Member States.

To harmonize the national legislation with the EAEU Customs Code, Kazakhstan has developed a new Customs Code, which is expected to come into force at the same time as the EAEU Customs Code in the beginning of 2018. Kazakhstan's new Customs Code introduces a number of changes to customs regulation in Kazakhstan and aims to modernize and facilitate the process of customs clearance. Below we outline the major changes introduced by Kazakhstan's new Customs Code.

Providing preliminary information and preliminary declaration of goods

Currently, the effective Customs Code of Kazakhstan includes a procedure for providing preliminary information to the customs authorities on goods to be imported, the vehicles transporting such goods, and time and place of arrival of the goods to the customs territory of the EAEU.

The current procedure for providing preliminary information requires importers to submit documents and information that are separate and not synchronized with the procedure of preliminary declaration of goods and subsequent customs clearance operations, such as notifying the customs authorities on arrival of goods, locating goods at temporary storage warehouses and filing declaration for vehicle and transit declaration.

After the new Customs Code is adopted, information provided in customs declarations with the preliminary declaration of goods can be used by the customs authorities as preliminary information.

If an importer does not submit a preliminary declaration of goods, the customs authorities may use the preliminary information submitted in electronic form as a source of information for executing subsequent customs operations without the need to resubmit the same information.

Also, the customs authorities will use the preliminary information to estimate the risks for violations of the law and to choose the type of customs control measures to apply before the goods arrive in Kazakhstan. This is expected to help optimize customs control procedures and facilitate customs clearance operations.

Electronic declaration of goods

The new Customs Code introduces mandatory electronic declaration of goods. Customs declarations will be submitted in electronic form without the need to submit supporting documentation.

Thus, customs declarations and the subsequent release of goods will be processed automatically by customs information systems without the involvement of the customs inspectors, unless the information systems identify any risks based on the information provided electronically.

Consequently, the focus of customs control with regard to customs valuation, classification codes and applied customs duty rates will be shifted to the post-customs clearance stage, which is expected to expedite customs clearance operations for releasing goods into Kazakhstan.

New regime for AEO

The status of Authorized Economic Operators (AEO) and related benefits may be obtained not only by declarants but also by shippers, customs brokers and owners of temporary storage/bonded warehouses.

Besides the existing main benefits, such as the possibility for temporary storage of goods and the ability to perform customs clearance operations at the AEO's premises, the status of AEO has been complemented with additional benefits with the effect of overall minimization of customs control. For example, it is no longer required to provide collateral for the customs procedure of bonded warehouse, when goods are released on condition of providing additional documents, or for deferred payment of customs duties. Moreover, goods may be delivered directly to the AEO warehouses without the need for approval of the delivery route under customs transit.

Based on the relevant international agreements concluded by the EAEU or Kazakhstan with non-EAEU countries, certain AEO benefits in Kazakhstan may be mutually provided to AEOs registered in such non-EAEU countries.

Deferred payment of customs duties

As opposed to the current customs legislation, which provides for deferred payment of customs duties only based on Kazakhstan's international agreements, under the new Customs Code, importers may apply for deferred payment of customs duties (one month or six months). In the case of a one-month deferral, importers pay an interest fee calculated on the basis of the official refinancing rate set by the National Bank of Kazakhstan.

Payment of customs duties may be deferred for up to six months without an interest fee because of natural disasters and other specific cases included in the Customs Code. Payment of customs duties may be deferred for up to six months with interest for goods to be used in industrial processing. The list of eligible goods is determined by the Eurasian Economic Commission (one of the EAEU bodies).

New opportunities for duty-free shops

Under the current customs legislation, sale of goods in duty-free shops is allowed only for individuals leaving the customs territory of the EAEU. To further develop the duty-free shops industry, sale of goods in duty-free shops also will be allowed for individuals arriving in Kazakhstan from non-EAEU countries, as well as individuals arriving or departing between the EAEU countries (e.g., when travelling from Kazakhstan to Russia).

Completion of customs declarations by the customs authorities

Under the new Customs Code, the customs authorities may complete the customs declaration without involvement of customs brokers. The plan is to initially allow transit and passenger declarations to be filled out by the customs authorities, and it is expected that in the future, the customs authorities will provide a similar service for all customs regimes. The details of this new service are yet to be developed.

Goods imported with exemption from customs duties under subsoil use and investment contracts

Currently, certain companies operating in Kazakhstan under subsoil use and investment contracts that provide for customs duty exemption are experiencing problems with the use and disposal of goods imported with exemption from customs duties before 1 July 2010 (when the current Customs Code was enacted).

Current customs legislation prohibits such companies to use goods imported with customs duty exemption for purposes other than those for which they were imported into Kazakhstan (e.g., specific projects). The goods may not be leased or sold to third parties because they remain under customs control for the effective period of the relevant subsoil use and investment contracts.

Thus, companies have to export such goods and re-import them to use them for other purposes (e.g., other projects) or to lease or sell them to third parties in Kazakhstan. When the new Customs Code enters into force, such goods will acquire the status of EAEU goods that may be freely used for other purposes.

Final thoughts

The procedures for implementing the changes introduced by the Customs Code are still being developed. Companies will need to continue to assess the extent to which the Customs Code achieves the aim of modernizing and facilitating the process of customs clearance.

Look for updates in future editions of *TradeWatch*.

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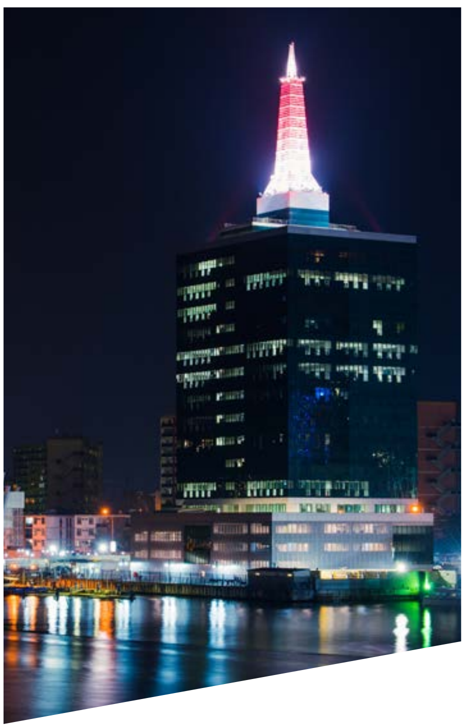

Nigeria

Nigeria's Senate conducts customs investigation

The Nigeria Senate is conducting an ongoing investigation into customs and marine transport activities from 2006 to 2017 through its Joint Committee on Customs, Excise and Tariff, and Marine Transport (the Committee).

The Committee's investigation is carried out by authority under Sections 62(1) and 89(1) of the Constitution of the Federal Republic of Nigeria 1999 (CAP C23 Laws of the Federation of Nigeria 2004) and Section 4 of the Legislative Houses (Powers and Privileges) Act. So far, the Committee has identified a number of issues, including erroneous classification, undervaluation and underpayment of duties, inappropriate documentation, under-declaration and incorrect origin.

Companies affected by this investigation are required to show appropriate documentation to evidence full compliance. The Committee also has indicated its intention to extend the investigation to operations in the Free Trade Zones.

Implications

The recent focus by the Government on internally generated revenue has resulted in more frequent desk examination reviews, as well as demand notices issued by the Nigerian Customs Service (NCS).

From all indications and with the continued pressure for non-oil revenue, corporate importers should anticipate more investigative activity from the relevant authorities leading to audits, investigations, issuance of demand notices and the imposition of penalties and interest.

Accordingly, importers should consider undertaking a customs and process improvement review among other proactive measures to manage their customs risks.

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Switzerland

Amendment to the rules applicable to mail-order companies

According to a study conducted by the Swiss Mail Order Association (*Verband des Schweizerischen Versandhandels*), private individuals ordered goods worth CHF7.2 billion[57] (approximately USD7.26 billion) via online mail order in the year 2015, of which purchases from abroad amounted to CHF1.1 billion (approximately USD1.1 billion). To ensure equal conditions for domestic and foreign online merchants from a value-added tax (VAT) and customs perspective, the legislature has decided to amend the rules for mail-order companies effective as of 1 January 2019.

Current rule for mail-order companies

The legislature defines the purpose and meaning of import VAT as follows: "Goods that are supplied domestically are subject to domestic tax. It would be a competitive disadvantage for (Swiss) taxable persons, if a rule were to render the importation of goods untaxed. They would be confronted with foreign competitors which supply goods directly to domestic consumers, without accounting for VAT."[58] This statement, however, does not reflect the current situation in the mail-order business, as the Swiss Federal Customs Administration (SFCA) in fact does not levy import VAT for deliveries where the tax would amount to CHF5 (approximately USD5) or less.[59] Because Swiss mail-order companies have to charge VAT on their domestic supplies, this disparity results in an advantage for foreign mail-order companies that do not have to account for VAT on their deliveries.

Amended rule as of 1 January 2019

For the purpose of ensuring competitive equality for Swiss and foreign mail-order companies, the legislator is introducing rules that reassign the place of supply of low value consignments (i.e., consignments where the amount of import tax is CHF5 or less). Going forward, the place of supply of such deliveries will be in Switzerland if the turnover generated by the foreign mail-order company for deliveries of such supplies to Switzerland amounts to at least CHF100,000 (approximately USD100,806) per annum. By shifting the place of supply of such deliveries to Switzerland, the foreign mail-order company becomes liable to register for and charge VAT in Switzerland once the turnover threshold of CHF100,000 from domestic deliveries has been exceeded.

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57 One billion is defined as one thousand million.

58 Factsheet of the SFCA 52.01, cipher 4.1.

59 Art. 53(1)(a) Value Added Tax Act, VATA.

A foreign supplier will have a mandatory tax liability in Switzerland from the effective date of the rules (1 January 2019) if its turnover related to supplies of low value consignments to Switzerland reached the threshold of CHF100,000 in 2018. Furthermore, a prerequisite for the tax liability is that the supplier will continue to supply low value consignments during the first 12 months after 1 January 2019.

Foreign mail-order companies already have the possibility of shifting the place of supply to Switzerland by voluntarily registering for Swiss VAT and applying for a subordination license for supplies to Swiss customers (Unterstellungserklärung Ausland). By registering for Swiss VAT and importing goods under a subordination license, foreign mail-order companies may import the goods and sell them with Swiss VAT, while receiving the right to deduct the paid import VAT as input tax in their quarterly VAT returns.

Switzerland as a pioneer in Europe

By introducing a mandatory tax liability for foreign online merchants that generate a turnover exceeding CHF100,000 per annum from the supply of low value consignments to Swiss consumers, Switzerland plays a pioneer role, which will likely be of particular interest to the Organisation for Economic Co-operation and Development (OECD). As a part of the base erosion and profit shifting (BEPS) action plan, the OECD has addressed the challenges of the use of tax exemptions as a business model. The recommendations in the BEPS reports published by the OECD in September 2014[60] suggest that the OECD would like to see a development in the direction now proposed by the Swiss legislature. In the report, the OECD points out that the issues related to low value imports cannot be resolved by abolishing the low value import exemption itself, as this would lead to a significant administrative burden for customs administrations. Instead, the OECD favors the approach of subjecting the foreign mail-order companies to a local VAT liability.

Conclusion

The proposed changes to the Swiss VAT law will impact foreign mail-order companies supplying low value goods to Swiss consumers. The option to preemptively register on a voluntary basis should be taken into account, as it could limit the administrative burden and associated costs. Concerned companies are advised to examine the implications of the new rules at an early stage, as the changes could trigger a tax liability in Switzerland.

Look for updates in future issues of *TradeWatch*.

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[60] BEPS reports available at: www.oecd.org/tax/beps-reports.htm.

Reduction of VAT rates in Switzerland

Importers and exporters doing business in Switzerland will soon be affected by recent changes in the Swiss value-added (VAT) law.

The public vote on 24 September 2017 to reject the Federal Act on the 2020 pension reform resulted in a change of Swiss VAT rates effective 1 January 2018:

- The standard VAT rate will be reduced from 8.0% to 7.7%.
- The special VAT rate for accommodation services will be reduced from 3.8% to 3.7%.
- The reduced rate of 2.5% remains unchanged.

Additionally, the partially revised Swiss VAT Act will enter into force as of 1 January 2018 and will introduce additional changes.

Swiss VAT payers will thus have to review the below areas to assess any urgent need for action:

- Adapt VAT-relevant enterprise resource planning (ERP) system configurations, for example, implementation of new accounts payable and receivable tax codes to cater for the new reduced VAT rates, whereby the historic tax codes should be retained.
- Update invoice templates.
- Consider transition rules for the tax point. Currently, it is expected that the time of supply should be decisive when determining the applicable VAT rate for transactions carried out across multiple tax periods, as opposed to the invoice date, which is otherwise the general tax point under the Swiss VAT law.

Look for updates in future issues of *TradeWatch*.

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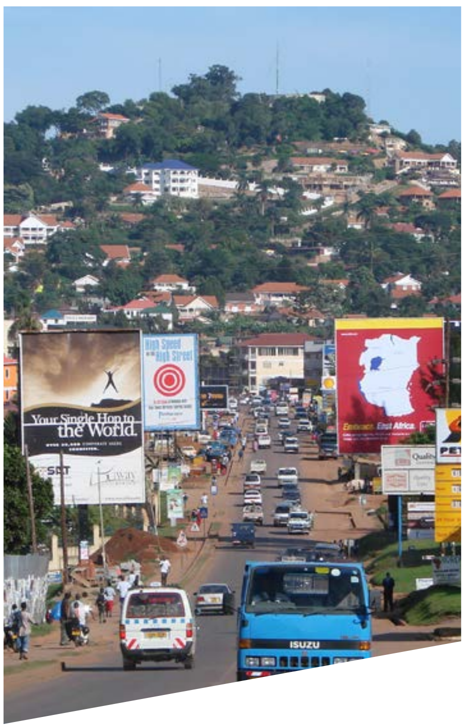
Uganda

Royalty payments and customs valuation — The Bata Uganda Ltd. Case



On 4 August 2017, the Tax Appeals Tribunal of Uganda (the Tribunal) delivered a monumental ruling affirming that royalties should not form part of the customs value of imported goods for import duty purposes unless the royalties are directly or indirectly related to the imported goods and their payment is a condition of the sale.

In Bata Shoe Company Co. Ltd v Uganda Revenue Authority (Bata Case) TAT No. 05 of 2015, the Tribunal stated that the two conditions should both be satisfied, otherwise the royalties should not be included in the customs value for purposes of computing import duties.

The Tribunal based its ruling on paragraphs 2, 9 and interpretative notes to paragraph 9 of the Fourth Schedule of the East African Community Customs Management Act (EACCMA). This provision was adopted from Article 8.1 (c) of the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade of the World Trade Organisation*. The Tribunal further relied on the guidelines contained in *Commentary 25.1 on the Third Party Royalties and Licence Fees issued by the World Customs Organisation Technical Committee on Customs Valuation*.

The dispute

Bata Shoe Co. Uganda Ltd (Bata Uganda) applied to the Tribunal for review of a taxation decision and additional assessment made by the Commissioner General, Uganda Revenue Authority (URA).

The basis for the additional assessment was that royalty fees paid by Bata Uganda to Bata Brands, Luxembourg (the Licensor) under the Trademark Licensing Agreement ought to have formed part of the customs value under the provisions of the Fourth Schedule of the East African Community Customs Management Act, 2004.

Bata Uganda in its defense argued that although the royalties paid were directly related to the imported footwear, their payment to Bata Brands was not a condition of sale of goods by third-party exporters based in Kenya, China and Singapore. Such payment of royalties to Bata Brands was never a condition of sale of goods and would, therefore, not form part of the customs value of the imported footwear under the applicable laws.

On its part, the URA argued that the payment of royalties by Bata Uganda to Bata Brands was a condition of sale of footwear from its third-party suppliers. The URA based its argument on the Trademark Licensing Agreement (the TLA) between Bata Uganda and Bata Brands, which set out Bata Uganda's obligation to pay annual royalties amounting to 2% of the annual total sales. Failure to make payment would result in termination of the agreement. URA further argued that the TLA gave Bata Brands sweeping powers to control and enforce the quality of products imported from third parties by Bata Uganda, as well as prohibited the use of the Bata trademark upon termination of the agreement. In URA's view, these terms within the TLA were proof that the payment of royalties was a condition of sale of the imported footwear.

The ruling

In its ruling, the Tribunal noted that there are two separate requirements that need to be satisfied for royalty payments to be part of the customs value of imported products. In the specific circumstances of Bata Uganda, the royalties were directly related to the imported footwear and, hence, the first requirement was fulfilled.

The second condition on whether the payment of royalty or license fees is a condition of sale of the imported goods also needed to be fulfilled. The Tribunal, citing Paragraph 9 of *Commentary 25.1 on the Third Party Royalties and Licence Fees issued by the World Customs Organisation Technical Committee on Customs Evaluation*, ruled that the following guidance applies:

- Whether there is a reference to the royalty or license fee in the sales agreement or related documents
- Whether there is a reference to the sale of goods in the royalty or license agreement
- Whether the sales agreement can be terminated as a consequence of breaching the royalty or license agreement when the licensee does not pay the royalties
- Whether there is a term in the royalty or license agreement that indicates that if the royalties or license fees are not paid, the manufacturer is forbidden to manufacture and sell the goods incorporating the licensor's intellectual property to the importer
- Whether the royalty or license agreement contains terms that permit the licensor to manage the production or sale between the manufacturer and importer that go beyond quality control

The Tribunal observed that none of the above factors had been proved in the Bata case to warrant the inclusion of royalties in the customs value. The Tribunal further noted that the clauses in the trademark licensing agreement that had been relied upon by the URA, for example, on prohibition of buying from suppliers that are not pre-approved by Bata Brands, were the usual clauses relating to quality control and not condition of sale clauses.

The Tribunal ruled that the royalty payments made by Bata Uganda to Bata Brands would, therefore, not be subjected to customs duties within the provisions of the law.

Conclusion

This case highlights the point that there are instances where royalty payments made by an importer are not a condition of sale of imported goods. In these instances, the royalty payments should not form part of the customs value. Nevertheless, every case may be different and should be considered on its own facts. By adopting the guidance contained in Paragraph 9 of *Commentary 25.1 on the Third Party Royalties and Licence Fees issued by the World Customs Organisation Technical Committee on Customs Evaluation*, the Tribunal sets down the guiding factors to be used in determining when a royalty payment may be considered a condition of sale of imported goods by the exporter, especially in cases involving a third-party exporter. As noted above, it is only where both requirements are fulfilled that the royalties should form part of customs value for purposes of computing customs duties payable by the importer of the goods.

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