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The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. The 'E' and 'Y' are connected at the top. A yellow diagonal bar is positioned above the 'Y'.

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Agreement in Principle reached on EU-Japan EPA: Potential for wide-reaching tariff reductions



On 6 July 2017, at the 24th Summit between the European Union (EU) and Japan in Brussels, the EU and Japan announced that an Agreement in Principle was reached with respect to the Economic Partnership Agreement (EPA) under negotiation between these parties.

The EPA's coverage is quite significant: in addition to traditional areas, such as trade in goods and services, investment and government procurement, the EPA is also expected to cover non-tariff barriers, geographical indications (GIs) and intellectual property rights (IPRs).

The EPA is expected to create an economic area with a total population of 640 million, covering 28% of global gross domestic product (GDP) and 37% of world trade. The EPA's entry into force will likely have a significant impact on Japanese and EU businesses.

Tariff reductions

The EU and Japan agreed to eliminate tariffs on a wide range of products covering 99% of imports from the other party.

1. EU tariff reductions

Primary exports from Japan to the EU (in value) include industrial products, such as transportation equipment, general machinery and electronics. The EU agreed to eliminate tariffs on all industrial products from Japan, either in stages or immediately upon entry into force of the EPA. Immediately upon entry into force of the EPA, tariffs on 81.7% of industrial products (86.6% of general machinery, 88.4% of chemical industrial products and 91.2% of electronics) will be eliminated, up from the current 38.5%, and exports of industrial products from Japan will become significantly more competitive on the EU market.

With respect to automobiles and automobile parts, tariffs on cars will be gradually reduced over seven years and will be eliminated from year eight. Tariffs on 92.1% (in value) of automobile parts from Japan will be eliminated immediately upon entry into force, exceeding the level of liberalization agreed upon in the Trans-Pacific Partnership (TPP) and EU-Korea Free Trade Agreement.



2. Tariff reductions in Japan

Japan also agreed to eliminate tariffs on all industrial products (including chemical products, plastics, cosmetics, apparel and leather goods) either in stages or immediately upon entry into force of the EPA. In particular, significant tariff reductions were agreed upon with respect to food products. Tariffs on wine from the EU will be eliminated immediately upon entry into force, and tariffs on products such as cheese and chocolates, currently subject to high tariff rates, will be eliminated in stages. Tariffs on beef and pork will also be reduced in stages. Another area of significant tariff reductions is footwear and leather handbags. Tariffs on footwear will be reduced from 30% to 21% upon entry into force and gradually eliminated over 10 years. Tariffs on leather handbags will also be eliminated over 10 years.

Rules of Origin and other provisions

In order to qualify for the reduced tariff rates provided for in the EPA, it is not sufficient for the goods to be merely exported from Japan (or the EU); the goods must qualify as “Japan originating” or “EU originating” pursuant to the criteria provided under the EPA (the Rules of Origin).

According to documents released by the EU, the Rules of Origin for automobiles and other vehicles (HS headings 8701-8705) require that such vehicles be made using no more than 45% non-originating material (NOM). However, for passenger cars (HS heading 8703), a more relaxed threshold of 55% NOM will apply for the first three years, a 50% NOM threshold for the following three years and a 45% NOM threshold beginning in year seven.

As for car parts, the NOM thresholds for chassis fitted with engines (HS8706) and bodies (HS subheading 8707) will be 45%, with a relaxed threshold of 55% applying for the first five years. The NOM threshold for automobile parts classified in HS subheading 8708 will be 50%, with a 60% threshold applying for the first three years.

The NOM threshold for footwear (HS Chapter 64) is 50% and for articles of leather (HS Chapter 42) is 45%.

Future developments

The Agreement in Principle covers significant content, such as tariff reductions for trade in goods, but negotiations will continue in other areas, including investor-state dispute settlement (ISDS). As a result of these negotiations, a final agreement is not expected until at least the end of 2017. The EU is planning for entry into force in early 2019, but Japanese officials have not yet formally specified a target date, and there is a lack of clarity on when the EPA will enter into force. Additionally, the ratification process could take some time, since, in addition to ratification by the European Parliament, ratification by each EU Member State would be required with respect to the areas where the EU does not have exclusive competence. For example, in the past, entry into force of the trade agreement between the EU and Canada (CETA) was delayed due to opposition from the local assembly in Walloon, Belgium. Therefore, developments must be closely monitored.



Comparison of most favored nation (MFN) and EPA rates

	MFN rate	Japan-EU EPA rate
Imports into the EU		
Japanese sake (HS2206)	EUR5.76 to 19.2/100L	To be eliminated upon entry into force
Television receivers (HS8528)	14%	To be eliminated on the sixth year
Passenger cars (HS8703)	10%	To be eliminated on the eighth year
Parts of passenger cars (HS8703)		
Chassis fitted with engines (HS8706)	19%	To be eliminated upon entry into force for 92.1% of the relevant trade
Bodies (HS8707)	4.5%	
Other parts (HS8708)	3%-4.5%	
Imports into Japan		
Beef (HS0201)	38.5%	9% on the 16th year with volume-based safeguard
Cheese (HS0406)		
Grated or powdered processed cheese	40%	To be eliminated on the 16th year for goods falling within the tariff rate quota
Soft type cheese (e.g., Camembert)	29.8%	
Chocolates (HS0406)	10%	To be eliminated on the 11th year
Wine of fresh grapes (HS2204)		
Sparkling wine	JPY182/L	To be eliminated upon entry into force
Bottled wine in containers holding 2L or less		
1) Sherry, port and other fortified wine	JPY112/L	
2) Other	Lesser of 15% or JPY 125/L, but subject to a minimum customs duty of JPY 67/L	
Bottled wine in containers holding more than 2L but not more than 10L	Lesser of 15% or JPY 125/L, but subject to a minimum customs duty of JPY 67/L	
Leather goods		
Handbags (HS4202)	14%	To be eliminated on the 11th or 16th year
Wallets and purses (HS4202)	10%-16%	
Golf shoes (HS6403)	27%-30%	

For additional information, contact:

Ernst & Young Tax Co. (Japan)

Yoichi Ohira, *Tokyo*
+81 3 3506 2678
yoichi.ohira@jp.ey.com

Yumi Haraoka, *Tokyo*
+81 3 3506 1262
yumi.haraoka@jp.ey.com

Comparing the US, Mexico and Canada key NAFTA objectives for renegotiation



The US, Mexico and Canada, having already agreed to move forward with formally renegotiating the North American Free Trade Agreement (NAFTA), held the initial round of negotiations on 16 to 20 August 2017 in Washington, DC. This was the first of seven scheduled rounds announced so far that will set the tone for detailed discussions of the key provisions among the three trading partners.

On 17 July 2017, the US Trade Representative (USTR) formally notified Congress of the objectives for the NAFTA renegotiation. This began the final 30-day period before the US could formally initiate NAFTA renegotiations with Canada and Mexico in accordance with the provisions of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA). On 31 July 2017, the Mexican Minister of Economy presented before the Mexican Senate a document detailing Mexico's priorities in the negotiations to modernize NAFTA. Officially, while the Government of Canada has not made a formal presentation of its negotiation objectives, the Prime Minister and Global Affairs Minister, among others, have heavily discussed them in the public domain.

Following is a summary of the three NAFTA countries' positions and objectives to discern the NAFTA areas that may be subject to changes during the negotiation.

United States position and objectives

In the 17 July 2017 notification to Congress, USTR Robert Lighthizer released a summary of the Administration's NAFTA renegotiation objectives, in accordance with the provisions of TPA. USTR Lighthizer had previously provided notice of intent to renegotiate NAFTA (in accordance with a 90-day Congressional notice requirement of TPA) on 18 May 2017.

In the Summary of Objectives for the NAFTA Renegotiation, USTR Lighthizer noted, "The America that existed when NAFTA was signed is not the America that we see today," and while NAFTA provided much-needed market access for some, such as American farmers and ranchers, it also "created new problems for many American workers" Specifically, USTR Lighthizer noted that "trade deficits have exploded, thousands of factories have closed, and millions of Americans have ... [been unable] to utilize the skills for which they had been trained" since NAFTA's 1994 inception.

During the pre-negotiation period, the USTR received more than 12,000 public comments and heard from more than 140 witnesses during the three days of public hearings. Testimony covered a wide range of sectors, including agriculture, manufacturing, services and digital trade. The objectives were completed based on this input, as well as input provided in other Trump Administration meetings.



The objectives place importance on the promotion of a market system leading to “reciprocal and balanced trade among the parties,” and at the same time noted that a successful renegotiation will benefit the economies and populations of both the US and its trading partners.

- ▶ **Persistent trade imbalances in North America** – The Administration is focused on addressing America's "persistent trade imbalances in North America" by promoting US exports. Specific objectives to that end include a focus on non-tariff barriers (such as tariff rate quotas that limit access), regulatory compatibility and improved cooperation on sanitary and phytosanitary measures to avoid unwarranted barriers, and transparency in customs processes and regulations.

In an effort to break down barriers to American exports, the objectives specifically include the elimination of unfair subsidies, market-distorting practices by state-owned enterprises and burdensome restrictions of intellectual property.

- ▶ **Stronger rules of origin to qualify goods for NAFTA preference** – Another primary theme continued in the Summary of Objectives relates to “stronger” rules of origin to qualify goods for NAFTA preference, in an effort to incentivize US and North American sourcing. The Administration seeks to “update and strengthen the rules of origin” to ensure that NAFTA benefits are given only to “products genuinely made in the United States and North America.” Presumably, “strengthening” rules of origin could relate to increased regional value content, stricter tariff shift requirements or a combination of both. For products that do qualify, an emphasis is placed on streamlining the customs processes, including the origin certification and verification processes, as well as on reducing operational burdens (via automation and paperwork reduction). In remarks made at the opening session, the USTR specifically referenced the automotive rules of origin as needing attention.
- ▶ **Dispute settlement mechanism** – The objectives also include a section on trade remedies, including the elimination of the chapter 19 antidumping and countervailing duty dispute settlement mechanism and the specific elimination of the NAFTA global safeguard exclusion so that it does not restrict the ability of the US to apply measures in future investigations.

- ▶ **Other areas of focus** – Enhanced trade in services and digital trade in goods, services and data were, as expected, included on the list of objectives. Opening investments and protecting intellectual property similarly have remained a priority, as have updating and placing labor and environmental provisions into the core agreement. Other sections of the objectives cover good regulatory practices, competition policy, anti-corruption, government procurement, small- and medium-sized enterprises, energy, dispute settlement, general provisions and currency.¹

Mexico's position and objectives

President Enrique Peña's Administration provided Mexico's position and objectives regarding the NAFTA renegotiation to the Mexican Senate on 31 July 2017. These have been grouped in four priority areas (listed below) that together are viewed as essential to strengthening Mexico's position in the global economy, extending the benefits of free trade to Mexican society and positioning North America as one of the world's most competitive regions. These positions and objectives were developed through the public consultation period that the Ministry of Economy initiated in February 2017.

- ▶ **Strengthen North American competitiveness** – Modernization of NAFTA must strengthen Mexico as a production and exportation platform by promoting more participation of Mexican industries and companies in global value chains. To achieve this objective, it is essential to:
 - a. Maintain preferential market access for Mexican goods and services in the NAFTA countries; specifically, facilitate access to agricultural products through clear rules, expedited procedures and elimination of trade barriers
 - b. Establish better customs procedures so that trade in goods is more predictable, agile and transparent
 - c. Promote leading practices in the process of planning, issuing, implementing and reviewing regulations
 - d. Expand the categories for the temporary entry of businessmen, improve time, transparency and processes for their admission, and identify innovative mechanisms for labor mobility

¹ Available at <https://ustr.gov/sites/default/files/files/Press/Releases/NAFTAObjectives.pdf>.



- ▶ **Advance toward inclusive and responsible regional trade** – The modernization of NAFTA is an opportunity for entrepreneurs and small and medium-sized enterprises (SMEs) to be incorporated into the international market and to include provisions related to labor, gender and the environment:
 - a. Create mechanisms for regional cooperation that promote SMEs' participation in regional supply chains
 - b. Strengthen compliance with international labor commitments
 - c. Strengthen cooperation and dialogue between the NAFTA countries in trade and the environment and improve the border infrastructure
 - ▶ **Take advantage of the opportunities in the 21st century's economy** – A lot has changed since NAFTA was enacted 23 years ago. North America's energy panorama has radically transformed thanks to the development of new technologies (e.g., access to shale gas) and the opening of the Mexican energy market, which generates investment and partnership opportunities. The development of information and communication technologies has spurred the digitization of the economy and the expansion of electronic commerce. In this new context, facilitating trade in services, promoting the integration of telecommunication infrastructure and strengthening the regional framework for the protection of intellectual property are essential tasks to generate more trade and investment opportunities supported by new technologies:
 - a. Update the scope of NAFTA's energy provisions to take advantage of the changes that have taken place in the energy sector in Mexico and the region
 - b. Promote the development of the digital economy, electronic commerce and the provision of financial services through digital platforms
 - c. Promote further integration of the telecommunication markets to take advantage of the Mexican reforms enacted in this sector
 - d. Develop efficient protections of intellectual property, maintaining a balance between public interest and innovators
 - ▶ **Promote certainty in trade and investment in North America** – It is essential to maintain and promote provisions that contribute to make foreign trade and investments more predictable. The dispute settlement mechanisms play a key role in this area and have demonstrated their efficiency for more than two decades:
 - a. Modernize the dispute settlement mechanisms established under NAFTA (investor-state, state-state, and those related to antidumping duties and financial services) to make them more agile, transparent and effective
 - b. Promote free competition, improving cooperation and the exchange of information between the authorities of the NAFTA countries in order to maintain market efficiencies and protection of consumer rights
 - c. Provide legal certainty to Mexican suppliers in public contract procedures in the region
- The Mexican Ministry of Economy also submitted a report to the Senate that addresses some additional topics. The report states that in early 2017, the Mexican President clearly stated the principles that would direct Mexico's commercial relations with the US, and these include the following:
- ▶ Mexico will not accept the implementation of duties, quotas or other mechanisms that restrict Mexican exports to the US.
 - ▶ Mexico is willing to modernize NAFTA to incorporate new disciplines.
 - ▶ Any modernization must consider the interest of the three parties and must remain a trilateral agreement.



Some of the main areas where the modernization of NAFTA should generate benefits, according to the report, are:

- ▶ Unrestricted market access for goods and services to the NAFTA region
- ▶ Implementation and use of rules of origin to guarantee regional benefits
- ▶ Modernization of customs procedures and trade facilitation
- ▶ Promotion of the integration of the North American labor markets
- ▶ Development in the participation of SMEs
- ▶ Enhancement of NAFTA's dispute settlement systems

Interestingly, the report mentions that it is not possible to disregard the possibility that the US may decide to withdraw from NAFTA. If that happened, it is presently Mexico's intent that NAFTA would continue to apply for Mexico and Canada, while World Trade Organization (WTO) provisions would apply for the US. The report states that Mexico must be prepared for this scenario through a commercial agenda of diversification of exports and foreign investment. Thus, in parallel to the modernization of NAFTA, the process to modernize the EU-Mexico FTA¹ and the EFTA-Mexico FTA² must be completed, as well as the further development of the Economic Complementations Agreements with Brazil and Argentina and the further development of the integration with the Asia-Pacific region through the Trans-Pacific Partnership Agreement with the remaining signatory countries.

The report states that while there are incentives for all NAFTA countries to have an expedited negotiation, the prevalent criteria will be for the quality of the negotiation and not the speed of the process.

Canada's position and objectives

To date, the Government of Canada has not released an official list of its objectives for NAFTA renegotiation, although public consultations were held with Canadians and Canadian businesses up to 18 July 2017.

Canadian Government officials have expressed their desire to modernize the trade agreement to bring it up to date with changes in the global economy since NAFTA was introduced in 1994. Canada's position is to ensure that modernizing NAFTA will reinforce the partnership among the three partner countries through increased cooperation and coordination toward greater liberalization and investment. Canada aims to advance a progressive trade agenda that supports broad-based, sustainable economic development in Canada and North America in general.

Based on scattered official government statements, the dispute mechanism in Chapter 19 of NAFTA and Canada's supply management system as it pertains to the dairy sector appear to be at the forefront of the government's priorities in the NAFTA renegotiation process. Although US negotiation objectives also specifically involve other Canadian business sectors (e.g., wine, aerospace), Chapter 19 and supply management have received the most attention in Canada so far. Talk of raising the de minimis limit for imports from CAD20 to CAD800 has also received some attention from the government due to the increasing economic importance of online shopping.

² Free Trade Agreement between Mexico and the European Union.

³ Free Trade Agreement between the European Free Trade Association States (Iceland, Norway, Liechtenstein and Switzerland) and the United Mexican States.



- ▶ **Supply management of dairy products** – Canada’s supply management system for certain agricultural products is based on three pillars: domestic price setting by the local marketing boards, control of supply through farm production quotas, and protection from foreign market influences through import quotas and tariffs. NAFTA rules would only be concerned with the third pillar, which applies quotas on imports of dairy products into Canada and imposes prohibitively high tariffs to any imports that exceed those quotas. US producers of dairy, and especially producers of diafiltered milk, have had their access to the Canadian dairy market effectively limited by the supply management quotas. While the US has labeled supply management as a barrier to trade in Canada-US trade relations, Canada’s current system is compatible with the tariffication of non-tariff barriers to trade that was brought about by the WTO Agreement on Agriculture. The Government of Canada has stated that it aims to defend Canada’s supply management system in the upcoming NAFTA talks.
- ▶ **NAFTA’s Chapter 19 dispute mechanism** – The Government of Canada has stated that it wishes to keep the mechanism outlined in NAFTA’s Chapter 19, “Review and Dispute Settlement in Antidumping and Countervailing Duty Matters,” in the re-negotiated agreement. In US-Canada trade relations, Chapter 19 has figured most prominently, in recent years, in the Canada-US softwood lumber dispute. The US lumber industry has argued that Chapter 19 is unconstitutional, as the arbitration system is outside the purview of the US legal system, and would prefer to scrap Chapter 19. Canada’s lumber industry has used Chapter 19 to successfully defend itself from antidumping and countervailing disputes with the US lumber industry. However, the application of Chapter 19 is not restricted to softwood lumber, so the impact of any decision on its inclusion or exclusion from an updated NAFTA could make other business sectors susceptible to antidumping and countervailing disputes, whether in Canada, the US or Mexico.
- ▶ **De minimis threshold** – Canada maintains one of the lowest de minimis value threshold for imported goods, currently set at CAD20. The purpose of a de minimis threshold is to exempt goods from customs duties, with the traditional rationale being that the costs incurred in collecting duties on shipments below the de minimis value exceed the benefits of collecting those duties. A more modern take on the rationale also factors in the liberalization of cross-border parcel shipments. Canada’s low threshold effectively means that most retail-volume purchases of goods online from the US, for example, are subject to duties upon importation into Canada. By contrast, the de minimis threshold for imports into the US was increased to USD800 in March 2016, meaning that US shoppers are more incentivized to purchase online goods from Canadian suppliers than vice versa. The US has expressed its desire to see the Canadian de minimis rate raised to CAD800, which would be more in line with the US threshold. Although the Government of Canada has not made any substantive statements regarding the de minimis threshold, opinion on this issue is divided among Canadian business stakeholders. Brick and mortar retailers, in particular, are concerned that a higher de minimis threshold will increase cross-border shopping in favor of US-based online retailers.

What to expect

There are some common positions and objectives among the NAFTA countries, for instance: use of rules of origin to guarantee regional benefits, focus on non-tariff barriers and regulatory compatibility, streamline customs processes, enhance trade in digital goods and further develop the energy market, etc. However, other areas may result in challenges during the renegotiation. Some of the more complicated topics could include modifications to the dispute settlement mechanisms, expansion of access to agricultural goods, among others.

Regardless of the topics and chapters that end up being adjusted when the renegotiations are finalized, it is likely that a new, modernized version of NAFTA will be enacted that includes changes to various areas, ranging from rules of origin and customs certification procedures, to government procurement and the dispute settlement mechanisms. As such, it is important for companies to identify aspects of NAFTA that currently benefit their businesses to be prepared to respond, on a timely basis, to the changes resulting from the negotiations.

For additional information, contact:

Ernst & Young LLP (United States)

Michael Leightman, *Houston*
+1 713 750 1335
michael.leightman@ey.com

Armando Beteta, *Dallas*
+1 214 969 8596
armando.beteta@ey.com

Sergio Moreno, *Miami*
+1 305 415 1383
sergio.moreno@ey.com

Sara Schoenfeld, *New York*
+1 212 773 9685
sara.schoenfeld@ey.com

Ernst & Young LLP (Canada)

Mike Cristea, *Fredericton*
+1 506 443 8408
mihai.cristea@ca.ey.com

Denis Chrissikos, *Montréal*
+1 514 879 8153
denis.chrissikos@ca.ey.com



Canada-EU Comprehensive Economic and Trade Agreement update: Delay in provisional implementation to autumn 2017 due to dairy, pharmaceuticals and ISDS disputes



In the December 2016 issue of *TradeWatch*, we discussed the signing of the Canada-EU Comprehensive Economic and Trade Agreement (CETA or the Agreement) and outlined some of the possible difficulties and delays likely to be encountered prior to full implementation, including those related to the dairy industry, investor-state dispute settlement (ISDS) system and other disputes, as well as the growing anti-globalization sentiment. This article provides an update of the CETA implementation process.

While Canada and the European Union (EU) have approved the necessary implementing legislation for the provisional application of CETA, the Agreement is still not in force on a provisional basis for those areas under the EU Commission's control (e.g., tariffs).

Canada's CETA implementing legislation, Bill C-30 (An Act to implement the Comprehensive Economic and Trade Agreement between Canada and the European Union and its Member States), received Royal Assent on 16 May 2017.

As the EU approved its own implementing legislation for CETA before Canada, Bill C-30 was the final step before the formal exchange of notification letters between the EU and Canada that would trigger provisional implementation of CETA.

As late as the end of May, the expected date for provisional implementation of the Agreement was 1 July 2017. The 1 July date came and went without the exchange of notification letters that CETA requires before the Agreement can be applied provisionally for areas within the parties' exclusive federal jurisdiction. Although 1 July 2017 was never officially set as the official date of implementation, stakeholders were expecting implementation by this date. For example, on 15 June 2017, the Canada Border Services Agency provisionally set out tariff code and data changes for the CETA provisions for electronic data interchange users.

A significant part of the delay in provisionally implementing CETA stems partly from uncertainty over details of the Canadian tariff rate quota (TRQ) increases for European cheese imports. Under CETA, Canada is expected to allow an additional approximately 18,000 metric tons of European cheese to be imported tariff free into Canada.



However, uncertainty over the distribution of access TRQ between Canadian or European producers and processors has the EU producers concerned that Canadian producers and processors will use their allotted TRQ (up to 60% of the new quota) to keep out finished European brand cheeses (either by not using it or using it to bring in bulk cheese for processing). The creation of new cheese TRQ under CETA was already a point of contention between the Government of Canada and the Canadian dairy industry, which had expressed concerns over the impact on domestic market share from increased European dairy imports.⁴

A second area of concern resulting in the delay of the provisional implementation of CETA is intellectual property protection for the pharmaceutical industry. Negotiated outcomes are already part of the CETA text, but the EU pharmaceutical industry has previously expressed its concern over dual-track litigation⁵ for generic drugs and the length of protection for drug patents. While dual-track litigation was not addressed in the CETA legal text, Canada previously agreed in principle to end dual-track litigation for patent infringement, which is burdensome to the generic pharmaceuticals industry. Moreover, Canada has advised that new regulations addressing this issue will be made public in the Canada Gazette. To date, the anticipated regulations have not yet been published, leading to some confusion and uncertainty. Reportedly,⁶ the European pharmaceutical industry had asked the European Commission to not set the date for provisionally implementing CETA until Canada publishes the regulatory changes. The EU has also expressed concerns regarding Canadian intellectual property protection guarantees for patented European pharmaceuticals.

A further reason for the delay is likely the concern about the new Investment Court set up under the ISDS system to settle investment and other disputes between corporations and member countries that bypass domestic or sub-sovereign jurisdiction courts. The ISDS system allows government laws and regulations to be challenged outside of domestic courts and was a major sticking point in the negotiations to allow for adoption within the EU states. It includes:

- ▶ A move to a permanent investment dispute settlement multinational tribunal or court where members would be appointed in advance by the parties
- ▶ The introduction of a “loser pay” system to reduce vexatious claims
- ▶ Allowing the tribunal to only apply the principles of the Agreement in accordance with customary international law principles
- ▶ The introduction of a judicial review appeal process based on a “correctness standard” rather than only on a “jurisdictional” basis
- ▶ The introduction of an Annex defining the “indirect expropriation” concept

While ISDS is not technically a provisional entry issue (it is part of the overall ratification of CETA in national and regional parliaments), it does seem to be affecting CETA’s momentum and could yet derail the trade deal. Continued focus on this non-trade aspect has caused other elements of the deal, such as the “negative list” drafting of CETA to be applicable to all aspects of the economy unless specifically excluded versus a positive list of where it applies, to come under scrutiny.

⁴ See *Dairy supply management in Canada and the challenge of diafiltered milk imports* in the June 2016 issue of *TradeWatch*.

⁵ A practice by which brand-name pharmaceutical companies sue generic makers multiple times on the same drug patent, adding to the cost and risk of bringing alternatives to market.

⁶ <http://www.cbc.ca/news/politics/ceta-provisional-application-pharmaceutical-litigation-1.4179676>.



The delay in provisional implementation is no doubt concerning to CETA stakeholders. This is especially so, considering that the remaining portions of the Agreement that require full ratification from all EU member states (i.e., ISDS) are expected to meet with difficulty in the ratification process. Nonetheless, the delay in provisional implementation is not out of character, as CETA has been fraught with delays and last-minute negotiations. The concern is that CETA support may be unraveling in this new era of anti-globalization.

According to a joint statement by Prime Minister Trudeau and European Commission President Juncker, the new expected provisional implementation date is around the corner and is set for 21 September 2017, provided there are no last-minute disputes or proposed changes that cause further delay. On this date, the vast majority of the Agreement (i.e. the noncontroversial provisions) will be provisionally applied and thus, 98% of tariff lines will become duty-free (currently, only 25% of tariff lines are duty-free). Upon full implementation, which will occur once the text is ratified by the Parliaments in all EU Member States, 99% of tariff lines will be duty-free.

Consistent with this intent, on 15 July 2017, the Government of Canada published numerous CETA regulations in the Canada Gazette, including regulations outlining CETA Rules of Origin, Tariff Preference Regulations, as well as an Order Amending the Schedule to the Customs Tariff. Moreover, details on the regulations amending the Vessel Duties Reduction or Removal Regulations and regulations defining the EU countries or other CETA beneficiaries have been posted. Orders amending both the Import Control List and the Export Control List have also been made public.

Look for updates and more insight into the CETA implementation developments in future issues of TradeWatch.

For additional information, contact:

Ernst & Young LLP (Canada)

Denis Chrissikos, *Montréal*
+1 514 879 8153
denis.chrissikos@ca.ey.com

Traci Tohn, *Montréal*
+1 514 879 2698
traci.tohn@ca.ey.com

Sylvain Golsse, *Montréal*
+1 514 879 2643
sylvain.golsse@ca.ey.com

Dalton Albrecht, *Toronto*
+1 416 943 3070
dalton.albrecht@ca.ey.com

UK publishes proposals for customs arrangements following Brexit



On 15 August 2017, the United Kingdom (UK) published its proposals for a future customs relationship with the European Union (EU) and a model for a time-limited transition period. These proposals will form part of the background to the next round of negotiations that started during the week of 28 August 2017.

The document, *Future customs arrangements: a future partnership paper*, is the first of a series of position papers to be released by the UK over the coming weeks and sets out its aims for the UK's future partnership with the EU. A paper relating to Northern Ireland has now also been published; however, the customs position paper is clear that the answer to avoiding a hard border between Northern Ireland and the Republic of Ireland cannot be to impose a new customs border between Northern Ireland and Great Britain.

Overview

The position paper sets out two broad future approaches. Under both, the UK leaves the EU Customs Union.

1. A highly streamlined customs arrangement between the UK and the EU, with customs requirements that are as frictionless as possible. This would include the adoption of technology-based solutions to make it easier for businesses to comply with customs procedures.

2. A new unique customs partnership with the EU, aligning the UK's approach to the customs border in a way that removes the need for a UK-EU customs border. One approach would involve the UK mirroring the EU's requirements for imports from the rest of the world where the final destination is the EU.

The UK Government is also keen to explore with the EU a model for an interim period immediately after the UK leaves the EU, which would ensure that businesses and people in the UK and the EU only have to adjust once to a new customs relationship. The position paper suggests that this could involve a new and time-limited customs union between the UK and the EU, based on a shared external tariff and without customs processes and duties between the UK and the EU.

Finally, the position paper notes that, in leaving the EU, the UK will require new domestic legislation. While the UK Government's preferred option is for an agreement with the EU, the government believes it is prudent to prepare for every eventuality. Accordingly, its Customs Bill will give the government the powers necessary to operate stand-alone customs, value-added tax (VAT) and excise systems following the UK's exit from the EU.



Options for the future

Until the UK leaves the EU, it will continue to be a member of the EU Customs Union and will continue to apply EU law on customs. Membership of the EU Customs Union means that:

- ▶ Goods moving between the UK and other EU Member States are not subject to customs duty, quotas or routine customs processes (including the need to provide customs declarations).
- ▶ Member States apply the EU's Common External Tariff (i.e., the same rates of customs duty) and its quotas and customs processes to goods that are moving between the EU and non-EU countries.
- ▶ The EU negotiates trade agreements, including tariffs, on behalf of all Member States.

The position paper confirms that as the UK leaves the EU, it will also leave the EU Customs Union. The paper sets out three strategic objectives:

- ▶ Ensuring UK-EU trade is as frictionless as possible
- ▶ Avoiding a "hard border" between Ireland and Northern Ireland
- ▶ Establishing an independent international trade policy

The UK Government will bring forward a trade white paper ahead of the trade bill in autumn. This will set out the government's approach to developing an independent UK trade policy. In particular, once it has left the EU, the UK intends to pursue new trade negotiations with other nations on its own account.

A highly streamlined customs arrangement

Once outside the EU Customs Union, the UK will need to extend customs processes to all UK trade with EU Member States, as well as continue to apply these to trade from partners around the world. The paper points out that these processes will need to:

- ▶ Ensure businesses declare goods for import or export and provide HM Revenue & Customs (HMRC) with the required documentation, including customs declarations, safety and security information, and any licenses required or supporting documentation (such as that required to demonstrate the origin of goods, as may be required under a future trade agreement between the UK and the EU)
- ▶ Enable HMRC to verify that a declaration has been made, that it corresponds to the goods arriving and to intervene, if necessary
- ▶ Ensure that any duties, such as customs duties and import VAT, are paid when goods arrive in the UK and the goods are released

The UK aims to negotiate trade facilitations with the EU and implement unilateral improvements to its domestic regime to make trade with the EU and the rest of the world easier. The paper recognizes that there will be an increase in administration compared with being inside the EU Customs Union. It suggests various ways to reduce the number or complexity of checks needed at borders, as well as speeding up authorization processes for traders.



Some of the examples set out in the paper include:

- ▶ Looking to simplify the requirements for moving goods across borders
- ▶ Options to reduce the pressure and risk of delays at ports and airports, including proposals to assist Authorised Economic Operators (AEOs), a status the government wants to support, through negotiating mutual recognition
- ▶ Negotiating customs cooperation, mutual assistance and data sharing that replicates existing levels of UK cooperation with other Member States to reduce revenue and security risks to the UK
- ▶ Reducing the time and costs of complying with customs administrative requirements through exploring the viability of unilateral measures, primarily in respect of imports

A new customs partnership with the EU

The streamlined customs arrangement above assumes that the UK and the EU trade with each other essentially as third parties and seeks to make the supporting customs processes as efficient as possible. The customs partnership proposal seeks to establish a new approach outside of a customs union arrangement, while still removing the need for customs processes at the border.

A particular approach the UK wishes to explore would involve the UK acting in partnership with the EU to operate a regime for imports that aligns precisely with the EU's external customs border, for goods that will be consumed in the EU market, even if they are part of a supply chain in the UK first. The UK would need to apply the same tariffs as the EU and provide the same treatment for rules of origin for those goods arriving in the UK and destined for the EU.

The position paper recognizes that there would need to be a robust enforcement mechanism that ensured goods that had not complied with the EU's trade policy stayed in the UK. It also acknowledges that this is an "innovative and untested approach that would take time to develop and implement."

An interim, time-limited arrangement

The government wishes to avoid any "cliff-edge" in the move from the current UK-EU relationship to whatever future partnership is agreed. It believes both the UK and the EU would benefit from an interim implementation period, which would allow for a smooth and orderly transition. The government believes it would be helpful if this principle could be agreed upon early in the process.

The position paper suggests that there could be a "continued close association" with the EU Customs Union for a time-limited period after the UK has left the EU. This could involve a new and time-limited customs union between the UK and the EU Customs Union, based on a shared external tariff and without customs processes and duties between the UK and the EU. The paper recognizes that the length of the interim period needs further consideration and will be linked to the speed at which the implementation of new arrangements could take place.

The position paper makes it clear that, once the UK has left the EU, it intends to pursue new trade negotiations with others. It notes that the UK would not bring into effect any new arrangements with third countries that were not consistent with the terms of the interim agreement, while the interim agreement was in place. This differs slightly from previous speculation that the UK would agree not to bring any new agreements into force until after the completion of the interim period.



What happens if there is no agreement?

While the UK hopes and expects to achieve a negotiated settlement that is in the interests of all parties, the position paper notes that it is only prudent that the government prepare for every eventuality. Regardless of the outcome of the negotiations, the government will need new domestic legislation to replace the existing rules, which are mostly in EU law. As promised in the Queen's speech, there will be a Customs Bill published in the autumn that, in addition to providing for negotiated outcomes, will give the government the powers necessary to operate stand-alone customs, VAT and excise systems.

In this scenario, without any further facilitation or agreements, the UK would treat trade with the EU as it currently treats trade with non-EU countries. Customs duty and import VAT would be due on EU imports. Traders would need to be registered. Traders exporting to the EU would have to submit an export declaration, and certain goods may require an export license. The EU would also apply the customs rules and VAT to imports from the UK that it applies to non-EU countries. The position paper notes that the government is actively considering ways in which to mitigate the impacts of such a scenario.

Implications

It remains to be seen how much discussion on the customs position paper will be entertained by the European Commission at the next round of talks. There is, however, a clear link between the question of the border between Northern Ireland and the Republic of Ireland and any customs arrangement, and the UK will hope that setting out its position will advance talks to facilitate, as noted in the customs position paper, "the freest and most frictionless trade possible in goods between the UK and the EU."

While the shape of any future trade agreement may start to be outlined over the coming months, clarity around the outcome of the complex trade negotiations may not be forthcoming for a while longer. Waiting until the end of the negotiation period may not leave enough time to take measured action before rules and trading arrangements change.

For additional information, contact:

Ernst & Young LLP (United Kingdom)

Marc Bunch, *London*
+44 20 7980 0298
mbunch@uk.ey.com

Mats Persson, *London*
+44 20 7951 1633
mpersson@uk.ey.com

Gerard Koevoets, *London*
+44 20 7951 6496
gkoevoets@uk.ey.com

James Bailey, *London*
+44 20 7760 9414
jbailey2@uk.ey.com

Marius Cosnita, *London*
+44 20 7197 9221
mcosnita@uk.ey.com

Penny Isbecque, *Leeds*
+44 113 298 2447
pisbecque@uk.ey.com

Susan Scott, *Glasgow*
+44 141 226 9343
sscott@uk.ey.com

Argentina

Update on Argentina's foreign exchange control system



In the March 2016 issue of *TradeWatch*, we discussed certain new regulations implemented by the Central Bank of Argentina (*Banco Central de la República Argentina*, BCRA) in line with the Argentine Government's policy of the control measures on foreign currency exchange. The current Argentine Government, which took office on 10 December 2015, has introduced some important changes in this regard focused on relaxing the requirements that operators should meet in order to access the foreign exchange market. Below we provide an update of this ongoing process.

Before 10 December 2015, and during the period from 2012 to 2015, residents in Argentina needed BCRA's approval to access to the foreign exchange market to make payments abroad. Companies faced various restrictions, especially when payments were directed to related companies. In practice, payments for royalties and services accrued in favor of foreign related companies could not be made in most cases and the term allowed for entering and converting payments originated in export of goods was generally short.

Additionally, at that time, Argentine companies and individuals did not have access to the foreign exchange market to purchase foreign currency to fund foreign accounts. Repatriation of investment, although not prohibited by law, was not allowed in practice as BCRA would not approve any transfer of funds abroad.

This situation started to change after December 2015 under the new government in Argentina with BCRA issuing a number of communications to implement new regulations aimed at eliminating or easing existing restrictions and barriers to the free circulation of goods. Transfers of funds abroad started to be accepted.

The new regulations allow nonresidents to repatriate new direct investments without BCRA's prior authorization and to make payment for royalties, services and dividends (both the accrued amounts and those originated in new operations). In this regard, it is important to mention that payments abroad for imports of goods and services can now be made without any limit through the foreign exchange market and the term to enter and convert payments for exports of goods on the foreign exchange market has been extended to 10 years.



Additionally, individuals and companies are now allowed to access the foreign exchange market to purchase foreign currency with no limitation and it is now also possible to fund foreign accounts without limits. Domestic savings in foreign currency are also allowed, subject to certain limitations.

As noted above, during the last year-and-a-half, BCRA has implemented a number of regulations regarding payments abroad for imports of goods and services, as well as collection of payments for exports. All of these regulations applicable to the new model of regulating the free circulation of capital in Argentina have been reorganized and consolidated in BCRA's Communication "A" 6244 dated 19 May 2017.

In line with the government's policy, the purpose of the new regulations is ultimately to attract new investment and capital into Argentina. These regulatory changes are ongoing and likely to continue for a long time. Look for updates in future issues of *TradeWatch*.

For additional information, contact:

Pistrelli Henry Martin y Asociados S.R.L. (Argentina)

Sonia I. Tucciarone, *Buenos Aires*

+54 11 4318 1600

sonia.tucciarone@ar.ey.com

Maia Sasovsky, *Buenos Aires*

+54 11 4318 1741

maia.sasovsky@ar.ey.com

Sergio I. Stepanenko, *Buenos Aires*

+54 11 4318 1648

sergio.stepanenko@ar.ey.com

Gustavo Scravaglieri, *Buenos Aires*

+54 11 4510 2224

gustavo.scravaglieri@ar.ey.com

United States

Organizational changes limit a company's ability to claim FTZ exemptions



On 22 June 2017, the Court of Appeals for the First District of Texas ruled that a Houston refinery was not entitled to Foreign-Trade Zone (FTZ)-related inventory tax exemptions.⁷ The case serves as a good reminder that the FTZ exemption for state and local taxes is dependent on activation of the FTZ. It also raises an interesting question as to a state court opining on activated status.

An FTZ is an area that is physically located within the United States but is considered outside of the customs territory of the United States. FTZs are used by manufactures and distributors to conduct US operations involving imported goods. One of the benefits available to FTZ users is an exemption from state or local property taxes imposed on FTZ inventory. The Foreign-Trade Zones Act provides that tangible personal property imported and held in a zone and domestic tangible personal property held in a zone for exportation is exempt from state and local ad valorem taxation.⁸ Importantly, for a company to obtain this benefit, it must both be located in an approved FTZ location, and that location and specific operating entity must be “activated” for use by U.S. Customs and Border Protection (CBP).⁹

In this case, the company had undergone several restructuring changes that resulted in a new FTZ operating entity. In the court’s view, because CBP did not directly approve the new operator, and instead only allowed FTZ operations to continue while it was reviewing the matter, the subzone was not considered “activated” and was therefore ineligible for the FTZ exemption.

Case background

The US FTZ program is set up so that an FTZ grant of authority for a region is provided to a “grantee,” generally, a public entity. Individual businesses in turn obtain FTZ status through the grantee. The grantee for the Houston area is the Port of Houston Authority. In 1995, an FTZ was established for Crown Central Petroleum Corporation through the Port of Houston Authority and designated Subzone 84N. In 2004, the refinery was sold to Pasadena Refining System, Inc., a Delaware corporation (PRSI(DE)), and CBP subsequently approved the new operating entity.

⁷ *Harris County v. Harris County Appraisal Dist., et al.*, 01-16-00389 (Tex. App. [1st Dist.] June 22, 2017).

⁸ 19 USC 810(e).

⁹ 15 CFR 100.1(c), 19 CFR 146.1(b)(2).



Additional entity restructuring changes in 2006 caused the FTZ operating entity to change once again, ultimately resulting in Pasadena Refining System, Inc., a Connecticut corporation (PRSI(CT)), as the entity conducting FTZ operations. The new entity, PRSI(CT), requested approval from CBP as the new operator, but CBP did not grant the approval because the Port of Houston Authority had not provided the requisite grantee concurrence letter. Consistent with a policy it adopted in July 2006, the Port of Houston Authority did not provide its concurrence letter for the operator change because PRSI(CT) had not obtained a letter of non-objection from Harris County (the county within which Houston is located).

CBP notified PRSI(CT) that the request for activation under a new operator was lacking the required Port of Houston Authority concurrence letter on 15 February 2008. PRSI(CT) then changed its position, stating to CBP that a new operator was not needed because of the corporate reorganizations. Thus began an extended exchange between CBP and PRSI(CT) as to whether or not a new activation was needed. During the pendency of the review, from 18 April 2008 until a final CBP decision on 27 March 2013, CBP allowed FTZ activities to continue through a series of month-to-month extensions of FTZ authority pending final resolution. The Harris County Appraisal District (HCAD) also continued to grant FTZ tax exemptions to PRSI(CT) each year. CBP ultimately determined that a new activation was necessary, and as PRSI(CT) was unable to obtain the requisite concurrence letter, CBP formally deactivated the FTZ on 23 August 2013.

Was the FTZ activated?

The principal issue in the case was whether the PRSI(CT) subzone had an authorized operator and was therefore “activated” from 2011 to 2013 (Harris County did not dispute any FTZ exemptions during the period prior to 2011). It is apparent that CBP never approved the new operator entity, which would have been processed as an activation under 19 CFR 146.6. However, CBP also never took action to deactivate the zone until August 2013. On appeal, Harris County argued that there had been no authorized operator of Subzone 84N since 2006 because CBP never approved the new operator. Harris County maintained that since PRSI(CT) never obtained approval from CBP as a new operator, it could not have obtained the authority to operate the subzone in activated status and, therefore, was not entitled to any FTZ exemptions.

PRSI(CT) and HCAD argued that CBP’s month-to-month letter approvals and continuous approval of zone admissions (214s), as well as annual blanket authorizations (216s) during the time in question, constitute the necessary approval by CBP to continue operations of the subzone and, therefore, PRSI(CT) was eligible to obtain the tax exemptions. They also claimed that the continuance of the grantee/subzone-operator agreement established a continuance of operator approval by the grantee.

Rendering judgment in favor of Harris County, the Court of Appeals ruled that the subzone could not have been activated during those years because CBP consistently declined to affirmatively approve the new zone operator, absent the requisite grantee concurrence letter, and thus, PRSI(CT) could not have been authorized to receive FTZ tax exemptions.

Broader implications

The case makes it clear that activation is a prerequisite to the FTZ property tax exemption. The case also serves as a good reminder of the importance of dealing promptly with any corporate reorganizations of an FTZ operator, as specifics of the corporate transaction can require new activation.

This decision is troubling, however, in that the Texas Court of Appeals is substituting its determination of the activated status of the FTZ for the determination of CBP, which has the regulatory responsibility for activation. If in fact the FTZ was not activated during the period in which CBP approved continuing operations, overall FTZ activity would seem improper, and consequences could be significantly broader than the property taxes at issue. The Court of Appeals decision was a split decision, with two justices in the majority and one in the minority. The dissenting opinion makes a strong case that CBP has the authority to determine activation and that the court should not disturb this authority if properly exercised. We suspect this case may be further appealed.

For additional information, contact:

Ernst & Young LLP (United States)

James Grogan, *Houston*
+1 713 750 5296
james.grogan@ey.com

Bill Methenitis, *Dallas*
+1 214 969 8585
william.methenitis@ey.com



Implementation of Customs Centers of Excellence and Expertise



Centers of Excellence and Expertise (CEEs) were created in 2012 in an effort to capitalize on US Customs and Border Protection's (CBP) trade expertise across the nation at various ports and to centralize decision-making in the post-entry process. CBP initially began testing the concept of having the CEEs handle certain trade functions previously assigned to individual port directors. Now, CEEs have become fully implemented for all importers, and CBP is actively assigning importers to the CEEs while further improving the overall responsibilities and functions expected by both CBP and the importing community.

On 29 June 2017, CBP published the "Centers of Excellence and Expertise Trade Process Document: Responsibilities and Procedures for Importers, Brokers, Agents, or Filers."¹⁰ The purpose of this document's release is to further clarify the responsibilities of importers and their brokers that impact CBP's ability to effectively operate the CEEs. As certain important changes and new importer expectations have resulted from this publication, importers should review their operations and make necessary adjustments to meet CBP's expected standards to minimize import delays or disruption and increased reviews or increased costs in meeting compliance obligations.

History of CEEs: an evolving program

CEEs are the new reality of today's trading world. Readily available data to both CBP and importers has accelerated entry processing, decisions and determinations, as well as provided for a more "account-centric" view of an importer's activity into the full customs jurisdiction. Historically, the Tariff Act of 1930 mandated decision-making to local customs officials at the port of entry where goods were imported. The customs officials would make decisions relating to classification, appraisement, release of merchandise, rate and amount of duty, and protests against liquidation, among other categories. However, this "port-specific" decision-making system faced criticism due to nationwide discrepancies in areas such as differing classification determinations impacting duty assessment or local procedures that varied from port to port.

¹⁰ Available at <https://www.cbp.gov/sites/default/files/assets/documents/2017-Jun/Center-Trade-Process-Doc.pdf>.



Thus, in 2012, CBP developed a test to incrementally transition certain operational trade functions from the port directors to the CEEs in an effort to “facilitate trade, reduce transaction costs, increase compliance with applicable port laws, and to achieve uniformity of treatment at the ports of entry for the identified industries.”¹¹

The test was deemed successful and, subsequently, Section 110 of the Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. 114-125 (24 February 2016), required that the CEEs be developed and implemented. On 20 December 2016, CBP ended the test period, established the CEEs as a permanent organizational component of the agency and transitioned certain additional trade functions to the CEEs.

Currently, there are 10 CEEs “headquartered” throughout the country, and each one focuses on a grouping of industries with all chapters of the Harmonized Tariff System (HTS) covered by one of the ten centers. Importers are assigned to the CEE that is most relevant to their primary industry sectors of importation by HTS numbers with the highest dollar value. As a result, each importer is associated with one CEE.

The respective industries and locations of these CEEs include:

- ▶ Agriculture & Prepared Products (Miami, Florida)
- ▶ Apparel, Footwear & Textiles (San Francisco, California)
- ▶ Automotive & Aerospace (Detroit, Michigan)
- ▶ Consumer Products & Mass Merchandising (Atlanta, Georgia)
- ▶ Electronics (Los Angeles, California)

- ▶ Industrial & Manufacturing Materials (Buffalo, New York)
- ▶ Machinery (Laredo, Texas)
- ▶ Petroleum, Natural Gas & Minerals (Houston, Texas)
- ▶ Pharmaceuticals, Health & Chemicals (New York, New York)

The CEE assignment of an importer of record, a particular entry summary or a post-summary activity is identified using a unique team code; this is similar to how local CBP port entry branch teams were previously assigned and, in fact, many teams with knowledge or skills in a particular industry are now aligned to the industry-specific CEE. Once an importer is assigned to a CEE, CBP processing for post-release aspects of the importer’s shipments (regardless of the tariff classification of the imported merchandise) will be redirected from the ports to the importer’s assigned CEE. Since the CEEs operate virtually, an importer will not need to change ports of entry nor will the entry process change.

Important changes to the CEE program

In January 2017, Title 19 of the Code of Federal Regulations was updated to provide Center Directors with full authority to make certain trade decisions, including post-summary processes, decisions related to country of origin marking, rules of origin, trademarks, copyrights, bonds, classification and appraisalment.

¹¹ See 77 FR 52048, 28 August 2012 (announcing test providing centralized decision-making authority for four CBP CEEs); 78 FR 20345, 4 April 2013 (announcing six new CEEs and additional regulations to be waived for test participants); 79 FR 13322, 10 March 2014 (modifying the existing test).



Within each CEE, there are three divisions:

- ▶ Partnership (to handle CEE participant accounts)
- ▶ Compliance and Validations (to handle other importers)
- ▶ Enforcement (to handle enforcement-related issues)

The level of participation in partnership programs and the risk level of the importer or the class of commodities define the divisions. The level of interaction and review an importer is likely to face is based upon the division it is assigned.

Responsibilities throughout the CEE, regardless of division, include entry or entry summary processing, rejections, cancellations, census warnings, reviews of antidumping and countervailing violations allegations, recordkeeping, financial and accounting matters, and post-entry work (such as liquidation, prior disclosures, Form 28 requests for information and Form 29 Notices of Action).

What should importers expect now from CBP's CEE program?

The development of CEEs reflects CBP's initiative to modernize the trade processes and provide for uniform national processing. Potential benefits of the initiative include, among others, CBP's greater understanding of industry issues, increased transparency and uniformity within a given industry, a more streamlined inquiry process to resolve issues, and a potential reduction in transaction costs for the trade community.

While there are broader benefits to be considered, importers may be wary of this change as it may lead to increased scrutiny and attention. In fact, companies may expect contact from their CEE at some point during the transition process. Ultimately, with an industry-focused approach, the CEEs will be better equipped to develop expertise and to identify and understand the issues and risks associated with each industry. Accordingly, companies should take care to consider their industries' risk areas and continually monitor compliance.

For additional information, contact:

Ernst & Young LLP (United States)

Michael Leightman, *Houston*
+1 713 750 1335
michael.leightman@ey.com

Sharon Martin, *Chicago*
+1 312 879 4837
sharon.martin1@ey.com

Sara Schoenfeld, *New York*
+1 212 773 9685
sara.schoenfeld@ey.com

Erin Fitzgerald, *New York*
+1 212 360 9225
erin.fitzgerald@ey.com

Recent OFAC enforcement actions for apparent violations of US sanctions demonstrate OFAC's broad jurisdiction



The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) recently imposed several civil financial penalties for apparent violations of US sanctions regulations. These enforcement actions highlight the compliance challenges facing companies under various economic and trade sanctions programs that, for example, restrict bank transactions and dealings with proscribed individuals or entities. Companies must regularly assess the adequacy of their compliance programs in response to sanctions programs that are frequently increasing in volume and complexity, are broad in reach and provide for strict liability for violations. In this article, we discuss one such OFAC enforcement action, which ended in a settlement agreement.

TransTel settlement

On 19 July 2017, OFAC entered into a USD12 million settlement agreement with a Singaporean entity, CSE TransTel Pte. Ltd. (TransTel) for apparent violations of the International Emergency Economic Powers Act (IEEPA) and the Iranian Transactions and Sanctions Regulations (ITSR).¹² IEEPA and ITSR have extraterritorial reach, as well as prohibit not only direct violations but also the causing of another person or entity to violate the sanctions regulations.¹³

TransTel had contracted with multiple Iranian companies for delivery and installation of telecommunications equipment for Iranian energy projects and had utilized third-party vendors, several of which were Iranian companies, to provide goods and services in connection with these transactions. TransTel made payments to these third-party vendors with funds that were apparently processed through the United States, as described below.

TransTel maintained both US dollar (USD) and Singaporean dollar (SGD) accounts with a certain Singaporean bank (the Bank). TransTel's then-senior management had assured the Bank in a Letter of Undertaking that it would not route any transactions involving Iran through the Bank. Nevertheless, TransTel appears to have used the Bank to wire USD funds, with total value over USD11 million, for payment to several third-party vendors involved with its telecommunication projects in Iran. These wire transfers appear to have been processed through the US. The wires documentation apparently did not reference Iran, the Iranian project or any Iranian parties.

¹² See OFAC Enforcement Information for 27 July 2017 available at https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170727_transtel.pdf.

¹³ See 50 U.S.C. § 1705 (a) of IEEPA and 31 C.F.R. § 560.203 of ITSR.



According to OFAC, because the wires appear to have been processed through the US and because of TransTel's alleged misrepresentation and failure to disclose that these transactions were related to services in Iran, TransTel appears to have caused several financial institutions, including US banks, to engage in prohibited export or re-export of financial services from the US to Iran.

At present, none of the financial institutions have been sanctioned for involvement in prohibited wire transfers. Rather, OFAC has focused its enforcement action on TransTel for allegedly causing US financial institutions to violate the sanctions regulations. Here, OFAC has exhibited its willingness to aggressively enforce US sanctions regulations beyond the borders of the US.

Implications for companies

In its enforcement actions, OFAC listed the aggravating factors it considered in assessing the amount of the penalty. Such aggravating factors included the level of sophistication and experience with US export sanctions, the routine involvement in transactions of controlled goods and the failure to consider warning signs of possible violations. Then-senior management allegedly having knowledge of and playing an active role in the apparent misrepresentations to a financial institution was another important aggravating factor in the action involving TransTel. These aggravating factors are good indications of the standards that OFAC uses and suggest that there should be several layers of controls in place to stop suspicious, if not outright prohibited, transactions.

Even where controls are in place, these must be constantly updated and refined. For example, many sanctions screening databases will typically look for words that include a sanctioned destination or party, such as Iran. However, TransTel's wire transfers did not appear to include any reference to Iran, the project in Iran, or any Iranian persons or entities. Thus, a

transaction might be prohibited under sanctions regulations even if underlying trade compliance or finance documentation, such as the wire instructions and messages provided to a bank, does not include any references to a sanctioned destination or person. For this reason, it is crucial that companies establish and maintain procedures that are tailored to a company's specific risk profile based on the nature of its operations and sales. Foreign entities that are lawfully transacting business through the US should have procedures in place to understand what the transaction relates to, the true identity of all parties involved and the location of the ultimate destination to avoid possible sanctions violations. Screening and investigation procedures, and associated controls, must be capable of detecting unauthorized transactions, even those that may lack apparent signs of sanctions violations.

Additionally, companies must be aware of the extraterritorial reach of US sanctions regulations and OFAC's willingness to enforce those regulations for activities occurring outside of the US. Notably, OFAC takes the position that the mere existence of a USD transaction is sufficient for OFAC to assert jurisdiction over the transaction, even if the activity is completely outside of the US and does not involve US origin goods. Therefore, non-US companies must ensure that their compliance programs also include measures to avoid possible violations of US extraterritorial sanctions.

For additional information, contact:

Ernst & Young LLP (United States)

Celine K Petersen, *Chicago*
+1 312 879 3681
celine.petersen@ey.com

Eric Rudolph, *Providence*
+1 401 457 3790
eric.rudolph@ey.com

China

Public notice regarding the promotion of the integrative customs clearance reform on a nationwide basis



On 28 June 2017, the General Administration of Customs (GAC) released a public notice regarding the promotion of the nationwide integrated customs clearance reforms (GAC Notice [2017] No. 25 or the Notice), which entered into effect on 1 July 2017.

Background

As part of the reform efforts of China's Central Government and the industry's desire for improved trade facilitation, the GAC issued the Notice and, in doing so, the newly created National Customs Risk Prevention and Control Center (RPCC), and the Tax Collection and Administration Center (TCAC) commenced operations as of 1 July 2017.

The customs reform in this round covers all goods specified in the Customs Import and Export Tariff of the People's Republic of China (the Tariff) crossing China's borders by any means of transportation through all ports nationwide. Note that current regional customs clearance centers will no longer perform the customs clearance function.

Main changes

The main changes of these reforms involve the establishment of the RPCC and TCAC and application of three new approaches, with details outlined in the table on the next page.



Center	Responsibilities
RPCC	
GAC Risk Prevention and Control Center (Shanghai)	<ul style="list-style-type: none"> ▶ Undertakes risk prevention and control over the importation and exportation of goods using the air freight mode of transportation on a nationwide basis ▶ Provides risk assessment of the supply chain enterprises involved in air transportation ▶ Sets and reviews the risk parameters to evaluate which shipments should be inspected based on the customs declaration information provided by the importer or exporter
GAC Risk Prevention and Control Center (Qingdao)	<ul style="list-style-type: none"> ▶ Undertakes risk prevention and control over the importation and exportation of goods using the sea freight mode of transportation on a nationwide basis ▶ Provides risk assessment of the supply chain enterprises involved in sea freight transportation
GAC Risk Prevention and Control Center (Huangpu)	<ul style="list-style-type: none"> ▶ Undertakes risk prevention and control over the importation and exportation of goods using land transportation (e.g., road and rail) on a nationwide basis ▶ Provides risk assessment of the supply chain enterprises involved in the land transportation of goods
TCAC	
GAC Tax Collection and Administration Center (Shanghai)	▶ Responsible for major categories of mechanical and electrical machinery/equipment, vehicles, technical instruments, etc. (i.e., Chapters 84-87 and 89-92 of the Tariff)
GAC Tax Collection and Administration Center (Guangzhou)	▶ Responsible for the major categories of chemicals, minerals, metals and their associated products, etc. (i.e., Chapters 25-29, 31-40 and 68-83 of the Tariff)
GAC Tax Collection and Administration Center (Beijing and Tianjin)	▶ Responsible for the major categories of miscellaneous commodities, such as agriculture, forestry, food, pharmaceuticals, textiles, aircraft, miscellaneous articles, etc. (i.e., Chapters 1-24, 30, 41-67, 88 and 93-97 of the Tariff)

The three new approaches include:

- 1) A single customs declaration may be submitted, but the new approach now involves a multi-step processing mechanism that manages and evaluates the customs declaration by the two centers mentioned above.
- 2) The importers or exporters are responsible for registering with China Customs (Customs) by submitting their customs declarations (and, in doing so, calculating their duty and import VAT liability), printing out their duty or import VAT invoices, and making payment on their own while Customs reserves the right to review documents during the entire procedure.
- 3) Integration of national customs resources to conduct a collaborative supervision.



This new initiative also will bring significant changes to the customs clearance management processes, as outlined below:

Customs process	Previous mode	New mode
Entry clearance/ declaration	The importer or exporter submitted his or her customs declarations. Customs verified before approving and releasing the goods (i.e., an approval approach).	The importer or exporter submits his or her customs declaration, and Customs releases the goods (i.e., an acceptance approach).
Import tax collection and administration	Customs calculated the duty/import VAT payable and issued the duty/import VAT invoices. The importer or exporter paid the duty/import VAT.	The importer or exporter calculates the duty/import VAT liability, prints out the duty/import VAT invoices and pays the applicable duty/import VAT.
Post-entry inspection	Customs reviewed the customs declaration data of goods imported or exported within its jurisdiction only.	TCAC can review the customs declaration data as per its assigned chapters on a nationwide basis.

Impact on enterprises

This reform will bring significant changes to the previous customs supervision approach. The main changes are the following:

- 1) Customs' clearance mechanism has changed from an approval approach to an acceptance approach to reduce manual intervention.
- 2) The importer or exporter has more responsibilities with respect to the calculation, declaration and payment of the applicable duty/import VAT.
- 3) By launching the two centers to review customs declaration data, the GAC expects to avoid the possible inconsistent implementation of customs regulations among different locations.



However, it is worth noting that these reforms enable Customs to increase supervision and administration over the customs clearance process and put a higher onus on importers and exporters to comply with the applicable customs laws and regulations.

- ▶ **Small mistakes may lead to big issues:** As the customs clearance approach has changed, Customs will, in most situations, no longer review declarations filed by importers or exporters in detail before the shipment release. As this new approach relies heavily on declarations made by the importer or exporter, any inconsistency not identified or corrected during the declaration process, but repeated in subsequent customs declarations, may have a cumulative effect. If identified by Customs during a post-entry audit, such inconsistency may trigger financial penalties, late payment surcharges and/or a downgrade to the importer's or exporter's customs rating (which may result in less facilitation and more scrutiny).
- ▶ **Customs is more likely to identify inaccurate customs declarations:** The TCAC can review declaration data related to its assigned Tariff chapters on a nationwide basis by using data analysis. Reporting different import prices and/or tariff classifications (HS codes) for the same commodity in different ports may be more easily identified and questioned.

- ▶ **It may become more challenging to resolve problems:** As the GAC directly handles these functions through the two centers, there is an additional layer for the importer or exporter to deal with. Thus, if an importer or exporter is challenged/questioned by Customs, they would need to deal with more departments than under the previous approach, making it more challenging to resolve issue(s) under the new post-entry audit process.
- ▶ **The frequency and intensity of post-entry audits will increase:** Currently, the China Customs Audit Division only accounts for 5% of Customs' total head count. During the reform and the reallocation of staff, the Audit Division will gradually increase to 20% of Customs' total head count. This change will greatly increase the frequency and intensity of post-entry audits.

Implications for importers and exporters

With respect to the above changes to the customs clearance environment, importers and exporters may enjoy faster customs clearances, but at the same time, they also face stricter compliance requirements. To be able to comply with these tougher requirements and better manage the associated risks, importers and exporters should:

- ▶ **Carry out regular health checks on periodic basis:** With the above changes, the compliance risk has increased, and regular health checks are an effective way to identify and mitigate potential risks.

- ▶ Make a voluntary disclosure as appropriate if any issue arises: For issues identified during the aforementioned health checks, such as an inaccurate tariff classification, import pricing, origin/preference claim, etc., importers and exporters may seek more lenient treatment or reduced financial penalties by making a voluntarily disclosure to Customs.
- ▶ **Become an Advanced Authorized Enterprise:** By becoming an Advanced Authorized Enterprise (China Customs' equivalent of the Authorized Economic Operator), the importer or exporter enjoys not only preferential measures provided by Customs (i.e., lower inspection rates and given priority when it comes to dealing with tariff classification, import pricing, origin/preference issues and/or other customs formalities) but also other incentives jointly issued by approximately 40 Chinese Government authorities.

For additional information, contact:

Ernst & Young (China) Advisory Limited

Bryan Tang, *Shanghai*
+86 21 2228 2294
bryan.tang@cn.ey.com

Ivy J. Chen, *Shenzhen*
+86 755 2502 8379
ivy-j.chen@cn.ey.com

Jerry Sun, *Shanghai*
+86 21 2228 8794
jerry.sun@cn.ey.com

James Z. Zhou, *Shanghai*
+86 21 2228 4491
james-z.zhou@cn.ey.com



China's new export control law

China is traditionally an export-oriented country, but export controls have not been a focus for both exporters and the Chinese authorities. While China's export control rules are currently implemented by different government agencies through various rules and regulations for specific products, there has not been an overarching law that serves as guidance in this particular area.

Given the current lack of integrated legislation, not many exporters are fully aware of China's export controls or, indeed, their obligations under each separate regulation. As China's exports continue to move into more high-tech products, more goods (e.g., chemicals, electronics, semiconductors) may be considered as "sensitive" from an export control perspective, according to the international treaties and conventions to which China is a signatory. Additionally, there have already been some instances where Chinese companies have been challenged and penalized by foreign governments for export control violations.

For the above and national security reasons, the Chinese Government recently released a draft of China's Export Control Law (proposed law) to seek public comment. The proposed law is China's first comprehensive law specifically designed to unify China's export controls by consolidating the aforementioned rules and regulations.

While the proposed law is not yet enacted, it is expected to enter into force in 2018, and it is anticipated that this will increase the compliance burden for some Chinese exporters when compared to their current obligations. Below are some highlights of the proposed law.

Scope

The scope of the proposed law includes dual-use, military, nuclear and other items as well as technologies and services that may affect national security.

Objectives

The key objectives (as they currently stand) are to protect China's national security and development interests, fulfill its international obligations for nonproliferation and enhance export controls.

New definitions

The proposed law defines certain terms, such as "export control," "dual-use," "military" and "nuclear." However, it is important to note that the expression "other items as well as goods and services that may affect national security" mentioned in the above scope is not defined, which may leave uncertainty as to what other items, technologies and services could potentially be covered.



Administration

The main thrust of the proposed law is to administer the export of controlled items through “controlled items lists” (prima facie, with one list for dual-use items and another for military arms and goods) that will require export licenses (either a general or specific export license) and possibly some form of registration requirement with respect to military arms and goods. It is also worth noting that certain products and/or technologies that do not appear on the controlled items lists may be designated as a “temporarily controlled item” by authorized government agencies and therefore could also be subject to the proposed law. Other administrative control mechanisms may include product, end use, end users and/or destination controls. To encourage compliance with the proposed law, new measures have been included, such as internal compliance, voluntary disclosure and whistle-blower mechanisms.

Enforcement

Under the draft law, the State Council and the Central Military Commission are primarily responsible for administering and enforcing the export controls, and, of course, Customs will play an important role for enforcement at the border. However, the draft law has not addressed how these and various other government agencies will coordinate; therefore, there could be administrative issues that arise once the proposed law is initially implemented.

Penalties

The penalties for noncompliance with the proposed law include the following:

- ▶ Companies (i.e., the exporter and/or the other companies involved in the export process) potentially may be liable for a fine between five to ten times the illegal business revenue
- ▶ Persons responsible for noncompliance may be personally liable for a fine between RMB100,000 to RMB300,000 (approximately USD15,000 to USD45,000)
- ▶ Cancellation or withdrawal of export privileges and licenses
- ▶ Confiscation of illegal business revenue
- ▶ Seizure of the goods in question
- ▶ Imprisonment of offenders

Implications for exporters

Given the implications of the proposed law, export companies should keep abreast of the changes to, and implementation of, the new export control law and its potential impact on their export obligations, as additional compliance requirements are likely to arise. Export entities need to be aware of their obligations and the implications to their export operations under the new rules.

For additional information, contact:

Ernst & Young (China) Advisory Limited

Bryan Tang, *Shanghai*
+86 21 2228 2294
bryan.tang@cn.ey.com

Mark Cormack, *Shanghai*
+86 21 2228 4634
mark.cormack@cn.ey.com

Japan

Liberalization of customs declaration policy to start 8 October 2017



In the June and December 2016 issues of *TradeWatch*, we discussed the upcoming liberalization of the customs declaration policy, which is slated to start 8 October 2017. We noted that under the new rules, the concept of “jurisdictions for customs declaration” will no longer apply to Authorized Economic Operators (AEOs). That is, on and after 8 October, AEOs engaged in import and export in Japan will no longer be required to submit customs declarations to the customs office with jurisdiction over the customs area where the goods are placed for import/export. Instead, AEOs will be able to file import and export declarations with the customs offices of their choice regardless of the physical location of the pertinent cargo. These measures were designed to help AEOs reduce costs and operate more effectively. As a rule, non-AEO importers and exporters will still be required to submit customs declarations to the customs office with jurisdiction over the customs area where the goods are placed for import/export; however, non-AEO importers and exporters can benefit from the liberalization by utilizing the services of an AEO customs broker and AEO logistics operator. Note that both the customs broker and logistics operator handling the goods for import/export must be AEO certified for a non-AEO importer or exporter to benefit from the liberalization.

More details regarding the new rules have been released in anticipation of the implementation, and, in this article, we will discuss practical and procedural issues related to the ongoing liberalization process.

1. Goods not subject to liberalization

AEOs may file import and export declarations with any customs office, except with respect to the following goods, which must still be declared to the customs office with jurisdiction over the customs area where the goods are placed for import/export:

- ▶ Exportation of weapons, their parts and accessories, as prescribed in the Export Trade Control Order
- ▶ Exportation and importation of goods subject to the US-Japan Mutual Defense Assistance Agreement

Additionally, goods regulated under the Convention on International Trade in Endangered Species of Wild Fauna and Flora and certain designated invasive species must be physically placed in a bonded area that is qualified to handle such goods, and the declaration must also be made to a customs office qualified to handle such declarations.



2. Declaration of goods physically located in multiple bonded areas

As a rule, separate customs declarations must be filed for goods physically located in different bonded areas. This rule would also generally apply to AEOs after liberalization; in other words, they must file a separate customs declaration for each bonded area, but all of such declarations can be filed with a single customs office. However, if all of the criteria below are met, a single customs declaration form may be submitted, even if the goods for import/export are located in separate bonded areas:

- ▶ The goods are located in bonded areas under the jurisdiction of a single customs office and are located within the same prefecture.
- ▶ Customs examination and inspection can be conducted without difficulty.
- ▶ Customs accepts the reason for the necessity to submit a single customs declaration.

3. Inspection and confirmation of goods

In principle, customs inspection and confirmation¹⁴ of goods pursuant to article 67 of the Customs Law is conducted by the customs office with jurisdiction over the bonded area in which the goods are physically placed for import/export. While AEO importers and exporters are generally exempted from customs inspection or confirmation, when such procedures are deemed necessary, the customs inspection and confirmation would be conducted by the customs office with jurisdiction of the bonded area in which the goods are physically located. However, in certain cases, the AEO importer/exporter may seek confirmation (but not inspection) at the customs office where the declaration is submitted by bringing the goods to such customs office for confirmation.

4. Filing of amended declarations, requests for refund, etc.

Amendments to import declarations and requests for refund of customs duties and import consumption tax will be submitted to the customs office to which the original import declaration was made.

However, the payment and refund of local consumption tax (2.2% of 8.0%) related to the imported goods will be made to and from the customs office with jurisdiction over the bonded area where the goods were placed for importation.

Furthermore, documents required for application of duty exemption, reduction or drawback will be submitted to the head of the customs office where the original import/export declaration was submitted.

5. Other practical issues

- ▶ Use of Nippon Automated Cargo and Port Consolidated System (NACCS): Where an AEO wishes to file an import/export declaration to a customs office other than the customs office with jurisdiction over the bonded area in which the goods are placed, the declaration must be made utilizing the NACCS electronic declaration system. (The ability to use NACCS is a condition of AEO certification.)
- ▶ Abolishment of business domain restriction for customs brokers: Under the current regulation, customs brokers are allowed to operate only within the jurisdiction in which it has obtained approval from the head customs office. Such restriction would prevent customs brokers from submitting customs declarations to the importer's/exporter's customs office of choice. Therefore, under the new rules, the business domain restriction on customs brokers will be abolished, enabling customs brokers to operate within any customs jurisdiction.

¹⁴ Customs confirmation constitutes examining the imported goods from the perspective of other applicable laws and regulations (such as export control), customs classification and infringement of intellectual property rights.



Implications for importers and exporters

Many importers and exporters have been somewhat skeptical about obtaining AEO certification because the benefit did not appear to outweigh the burden of obtaining certification and maintaining AEO status. However, the implementation of the new customs declaration rules brings additional benefits to becoming AEO certified. While non-AEO importers and exporters can benefit from the liberalization by using AEO customs brokers and logistics providers, particularly the latter can be challenging to arrange from a cost and availability perspective. Therefore, companies importing into or exporting from Japan may wish to consider applying for AEO certification to secure a competitive advantage.

For additional information, contact:

Ernst & Young Tax Co. (Japan)

Yoichi Ohira, *Tokyo*
+81 3 3506 2678
yoichi.ohira@jp.ey.com

Yumi Haraoka, *Tokyo*
+81 3 3506 1262
yumi.haraoka@jp.ey.com

East African Community Key takeaways for importers and exporters from the EAC Customs Gazette 2016/17



The budget proposals for each of the East African Community (EAC: Burundi, Kenya, Rwanda, South Sudan, Tanzania and Uganda) partner states are read on the same day save for this year when Kenya was anticipating elections and had the budget reading at the end of March 2017. Uganda, Tanzania and Rwanda had their budget reading on Thursday, 8 June 2016. The EAC customs and international trade proposals are, however, negotiated by all the member countries and became effective 1 July 2017. Below is a commentary on some of the key changes from the EAC Gazette that will affect importers and exporters across the region.

EAC CET 2017 version comes into force

The Common External Tariff (CET) is revised every five years from a World Customs Organization (WCO) perspective, and, as members, EAC is required to implement the revision. The EAC CET 2017 came into force effective 1 July 2017. The EAC Council of Ministers reviewed and modified the EAC CET into a 2017 version.

Duty exemptions

The Fifth Schedule to the EAC Customs Management Act (CMA), 2004 contains the duty exemptions. The following changes to the Fifth Schedule were approved:

- ▶ Compact fluorescent bulbs and light-emitting diodes – The Council approved the deletion of this item as this exemption is no longer relevant due to technological advancements.
- ▶ Machinery, spares and inputs for direct use in oil, gas and geothermal exploration – The current provisions provide for exemption on equipment and inputs imported by a licensed company for the direct and exclusive use in oil, gas or geothermal exploration and development. The paragraph was amended to include distribution as well.

Harmonized System (HS) codes split in the CET

Various HS codes have been split to provide more specific classification. Some iron and steel products of tariff items 7213 and 7216 have been further classified based on the height of those products. Additionally, 8414.80.90 has been split to provide a specific tariff code for wind-driven roof ventilators, and tariff item 9616.10.90 has been split to provide for a CET rate of 10% for trigger spray and lotion pumps – 9616.10.99.



Kenya changes

Duty remission scheme – Section 140 of the EAC CMA gives mandate to member states to remit duty on goods that are to be used as raw materials in manufacture of goods for subsequent export or domestic consumption. It is given on application by the company, and once the application is approved, the qualifying companies are gazetted for a period of 12 months:

- ▶ **Wheat grain** – Kenyan gazetted millers will be approved to import wheat grain of tariff items 1001.99.10 and 1001.99.90 under the duty remission scheme at the rate of 10% instead of 35% for one year. Tanzania was granted the same approval.
- ▶ **Motorcycle kits** – The Council granted duty remission to gazetted assemblers to import motorcycle CKD (completely knocked down) kits at a rate of 10% instead of 25% for one year. This will boost domestic assembly of motorcycles, which are a popular means of transport in the region.
- ▶ **Sugar for industrial use** – In 2015/16, the Council decided to reduce duty remission levels on sugar for industrial use progressively. Considering that, currently, there is no local production of industrial sugar in the region, the Council agreed to maintain the rate of 10% for another one year for sugar for industrial use of tariff item 1701.99.10.
- ▶ **Raw sugar for refining** – Kenya was granted duty remission at a rate of 0% for one year to allow gazetted sugar millers to import raw sugar of tariff item 1701.14.90 for refining into industrial sugar.
- ▶ **Inputs used in the manufacture of filters** – The Council granted duty remission for specific inputs used in manufacture of oil and air filters, including gaskets, washers and other seals, glues and adhesives, packaging materials, stoppers and inserts, articles of iron and steel, and others.

The condition for applying the above remissions is that in the event that finished products from raw materials are sold in the EAC customs territory, such goods will be subject to duties, levies and other charges provided in the EAC CET.

Stay of application of the CET – The following paragraphs highlight some goods that will not be taxable per the CET, 2017.

Rice

Kenya has been granted an extension of the stay of CET application on rice of tariff items 1006.10.00, 1006.20.00, 1006.30.00 and 1006.40.00 to apply a rate of 35% or USD200/MT (metric ton), whichever is higher, instead of 75% or USD345/MT for one year. Rwanda has also been allowed a stay of application of the CET rate and will apply a duty rate of 45% or USD345/MT. This is to supplement the food requirements in the two countries.

Paper and paper board

There is sufficient capacity in Kenya to produce paper products of tariff items 4805.19.00, 4805.91.00, 4805.92.00 and 4805.93.00 to meet the local demand. In this regard, Kenya was granted an extension of the stay of CET application to apply a duty rate of 25% instead of 10% for these products for one year.

Products and structures of iron and steel

Kenya was granted a stay of CET application to import iron and steel products of the following HS tariff items at a rate of 25% or USD250/MT instead of 25% for one year: 7210.41.00, 7210.49.00, 7210.61.00, 7210.69.00, 7210.70.00, 7210.90.00, 7212.30.00, 7212.40.00, 7212.50.00, 7212.60.00, 7210.90.00, 7210.30.00, 7308.10.00, 7308.20.00, 7308.40.00, 7308.90.91, 7308.90.99, 7320.10.00, 7320.90.00 and 7318.23.00.



Kenya was further granted a stay of CET application to apply a rate of 10% or USD125/MT instead of 10% for the following tariff items for one year: 7209.16.00, 7209.17.00, 7209.18.00, 7209.26.00, 7209.27.00, 7209.28.00 and 7209.90.00.

Screws, bolts, rivets and nuts

Kenya was granted a stay of CET application to import screws, bolts, rivets and nuts of tariff items 7318.15.00 and 7318.16.00 at a duty rate of 25% or USD250/MT for one year in order to protect local manufacturers of these finished products that are available locally in sufficient quantities.

Gas cylinders

Kenya has sufficient capacity to produce gas cylinders to meet the local demand. Accordingly, Kenya was granted an extension of the stay of CET application for one year to import gas cylinders of tariff item 7311.00.00 at a rate of 25% instead of 0% to protect the local manufacturers. Uganda was granted a similar stay.

Road tractors for semitrailers

Kenya was granted a stay of application of the CET rate to apply 25% instead of 10% on road tractors of tariff item 8701.20.90 for a period of one year. This is to protect local manufacturers of the same goods in Kenya. Burundi, Rwanda and Uganda will stay application of CET and apply a 0% duty rate for one year.

Safety matches

Kenya was granted a stay of application of the CET rate to apply a duty rate of 25% or USD1.35/Kg, whichever is higher, on safety matches of tariff item 3605.00.00 for a period of one year.

Styrene acrylic

Kenya was granted a stay of CET application to apply a duty rate of 10% instead of 0% on styrene acrylic of tariff item 3903.20.00 for one year.

Polyvinyl alcohol

Kenya was granted a stay of CET application to apply a duty rate of 0% instead of 10% on polyvinyl alcohol of tariff item 3905.30.00 for one year.

Ready-made garments

Kenya requested for a stay of application of the CET on ready-made garments procured from Export Processing Zone (EPZ) companies at the rate of 0%. The Council granted the stay to Kenya for one year on the condition that the 20% limit allowed under the EAC Customs Union Protocol is not exceeded and the goods thus obtained are not to be sold to other partner states.

Worn items of clothing

Kenya was granted a stay of application of the CET rate on worn clothing of tariff item 6309.00.10 to apply a rate of 35% or USD0.2/Kg instead of 35% or USD0.4/Kg for one year.

Uganda-specific changes

Crude palm oil

The 10% import duty on crude palm oil that was granted at pre-budget 2016/2017 has been reinstated. The same rate will apply for Tanzania.

Cement clinker

Cement clinker was removed from Uganda's list of raw materials that are subject to duty remission and preferential treatment. Cement clinker will therefore be imported at the CET rate of 10%.

Penstock pipes

Import duty was removed on imports of penstock pipes for use in hydroelectric power projects. These pipes fall under HS Chapters 39, 70 and 73.

Jacquard material

Jacquard material for making spring mattresses (printed with logo) and plain mattress covers will be imported at a duty rate of 10% instead of the CET rate of 25%. This is to support the growing mattress industry in the country.

Barley

Uganda will also stay application of the CET rate and apply a duty rate of 10% instead of 25% on barley imports. This is to support consumption as there is a current shortage of barley in the country.



Base oil and crude edible oil

Uganda will stay application of the CET rate and apply a duty rate of 0% instead of 10% for one year on base oil, and both Uganda and Tanzania will stay application of the CET rate of 0% and apply a 10% duty rate on crude edible oil, which is readily available in both countries unlike base oil.

New pneumatic tires of rubber of a kind used on motorcycles

To discourage importation of motorcycle tires and encourage assembly of full motorcycles, Uganda will stay the application rate of 10% and instead apply the rate of 25%.

Rwanda

Rwanda generally obtained stays of application of the CET and had most items approved for importation at 0% and 10% lower duty rates. Some of these include:

- ▶ Flat-rolled products of iron or non-alloy of steel of tariff items 7208.52.00, 7208.53.00, 7208.54.00 and 7208.90.00 – 0% rate
- ▶ Iron and steel products of tariff items 7213.99.00 – 0% rate
- ▶ Iron and steel products of tariff items 7308.40.00 and 7213.10.00 – 10% rate
- ▶ Products of iron or steel of tariff items 7213.20.00, 7227.10.00, 7227.20.00, 7227.90.00, 7308.20.00 and 7318.15.00 – 10% duty rate
- ▶ Tariff item 9406.90.90 – 10% duty rate
- ▶ Road tractors for semitrailers of tariff item 8701.20.90 – 0% rate

The EAC partner states continue to work toward achieving full implementation of a Customs Union and a Common Market recognizing the unique demands and challenges of each country. The common challenge for all the partner states is achieving tax revenue independence that would fully satisfy each country's budget requirements and needs. This will mainly be achieved by better tax administration and tax policy measures that result in widening of the tax bases. Taxpayers, therefore, need to keep the tax agenda key on their boardroom priority issues.

For additional information, contact:

Ernst & Young (Uganda)

Hadijah Nannyomo, *Kampala*
 +256414343520
 hadijah.nannyomo@ug.ey.com

European Union

Customs valuation under the Union Customs Code



On 1 May 2016, the majority of the provisions of the Union Customs Code (UCC),¹⁵ the Delegated Act (UCC-DA)¹⁶ and the Implementing Act (UCC-IA)¹⁷ became applicable. In addition to this new EU customs legislation, the European Commission published non-binding guidance (Guidance on Customs Valuation) to provide detailed instructions on how to interpret the new customs legislation and achieve a uniform interpretation and implementation in each EU Member State.¹⁸

The interpretation and application of the new EU customs legislation can, however, often be uncertain, particularly regarding customs valuation of imported goods. In particular, the more stringent rules on the inclusion of royalties in the customs value and the new rules on determining the sale for export in multiple party supply chains are notable.

Although the dust is still settling and the customs authorities and affected parties are still evaluating their positions, it is time to share some observations and experiences from the last year-and-a-half. In addition, in this article, we discuss some interesting cases from the European Court of Justice (ECJ) about customs valuation matters to be decided under the Community Customs Code (CCC, applicable until 1 May 2016)¹⁹ that remain relevant and have impact under the UCC.

The treatment of royalty and license fees

Under the more stringent new rules, royalty and license fees are under scrutiny in the EU. While the new rules no longer provide a definition of royalty and license fees, the UCC does provide a definition of the “condition of sale.”

¹⁵ Regulation (EU) No. 952/2013 of the European Parliament of the Council of 9 October 2013 laying down the Union Customs Code (recast).

¹⁶ Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code.

¹⁷ Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No. 952/2013 of the European Parliament and of the Council laying down the Union Customs Code.

¹⁸ Guidance on Customs Valuation (23 April 2016), Taxud B4/(2016) 808781 revision 2, p. 22.

¹⁹ Council Regulation (EEC) No. 2913/92 of 12 October 1992 establishing the Community Customs Code.



Further, the trademark royalties exception is no longer included in the new EU customs legislation, and trademark royalties are now subject to the same rules as for other royalties and license fees.

In the Guidance on Customs Valuation, the European Commission provides that a useful definition of royalties and license fees can be found in the Organisation for Economic Co-operation and Development (OECD) Model and Tax Convention on Income and on Capital (2014):

... payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial, or scientific experience (commonly referred to as “know-how”).²⁰

To prevent undervaluation of the imported goods, royalty and license fees are added to the transaction value of the imported goods if three cumulative conditions are met:

1. The royalty and license fees are not yet included in the price actually paid or payable for the imported goods.
2. The royalty and license fees relate to the goods being valued.
3. The buyer must pay the royalty and license fees, either directly or indirectly, as a condition of sale.

The more stringent rules concern the non-cumulative conditions included in the UCC-IA about the definition of a “condition of sale,” which was not defined as such under the CCC. There is a “condition of sale” if:

1. The seller, or a person related to the seller, requires the buyer to make this payment.

2. The payment by the buyer is made to satisfy an obligation of the seller, in accordance with contractual obligations.
3. The goods cannot be sold to, or purchased by, the buyer without payments of the royalty or license fees to a licensor.

The European Commission indicates in the Guidance on Customs Valuation that royalty and license fees are not automatically includible in the customs value. However, in particular, the situations described under 2 and 3 above seem to imply that royalty and license fees become dutiable in more situations because of the “condition of sale” definition under the UCC. It seems that under the UCC, the payment of a royalty or license fee constitutes a “condition of sale” of the imported goods if the seller (or the person related to him or her) is not prepared to sell or cannot sell the goods without payment of the royalty or license fee. In other words, if the buyer is not able to acquire the imported goods without paying the royalty or license fee, the royalty payment should be included in the customs value of the imported goods.

In practice, the customs authorities have increased scrutiny of payments of royalty and license fees and, especially, royalty payments for trademarks. Under the CCC, royalty or license fees for the right to use a trademark were only added to the price actually paid or payable for the imported goods where “the buyer is not free to obtain such goods from other suppliers unrelated to the seller.” Under the UCC, a contract that permits the buyer to acquire the goods without payment of royalties from an unrelated seller no longer enables the buyer to exclude the trademark royalty fee from the customs value.²¹

²⁰ OECD Model and Tax Convention on Income and on Capital (2014), Article 12, paragraph 2.

²¹ See also Conclusion AG Mengozzi 28 July 2016, No. C-173/15 (GE Healthcare).



As mentioned above, royalty and license fees are under scrutiny by the customs authorities because of the more stringent rules and because the European Commission encourages the customs authorities to examine all commercial contracts, or reach conclusions on contractual intentions or obligations, to determine whether royalty and license fees are dutiable. In the near future, the customs authorities are likely to have greater insight in intercompany supply chains and payments. The customs authorities would be able to gain access to commercial contracts easily, because the measures of Action Plan 13 require multinational enterprises (MNEs) to keep and share detailed records and documentation on a country-by-country basis.²² As royalty and license fees are expected to be under such scrutiny for years to come, importers need to monitor carefully their supply chains and intercompany payments.

Determining the last sale for export in multiple party supply chains

Under the UCC, the customs value is determined on the basis of the sale occurring immediately before the goods were brought into the customs territory of the EU. This approach is also referred to as the “last sale (for export)” rule. Under the CCC, however, the customs value in the case of successive sales could be based on an earlier, or the first, sale. Needless to say, using an earlier or first sale is likely to result in lower customs duties.

The meaning of the last sale rule is unclear. Based on Advisory Opinion 14.1 of the World Customs Organization, the last sale rule relates to a sale that brings the goods into the customs territory of the EU. If no such sale exists, in principle, an alternative valuation method applies.

An exception, however, applies if the goods are not sold for export to the customs territory of the EU before they were brought into EU customs territory but while in temporary storage or while placed under a special procedure. In that case, the transaction value method can still be applied, but it is then based on the subsequent sale from the warehouse to the customer in the EU.

It became apparent after the publication of the Guidance on Customs Valuation that an exception to the last sale rule also applies in the case of a so-called “domestic sale.” According to the European Commission, a domestic sale takes place if the buyer and seller are both located in the EU. Although the European Commission did not explain the requirement “in the EU,” it appears that a domestic sale takes place if the seller and buyer are both established in the customs territory of the EU.

A person is established in the customs territory of the EU if:²³

- ▶ In the case of a natural person, any person who has his or her habitual residence in the customs territory of the EU
- ▶ In the case of a legal entity or an association of persons or entities, any entity having its registered office, central headquarters or a permanent business establishment in the customs territory of the EU

It is arguable that the domestic sale constitutes the partial revival of the “first sale” rule because the customs value should then be determined on the preceding sale if that sale constitutes a sale for export. If there was not a preceding sale qualifying a sale for export, the customs value should be determined using an alternative valuation method.

²² The Base Erosion and Profit Shifting (BEPS) project is an OECD study to establish whether and, if so, why current legislation allows taxable profits to be allocated to states other than those where the related business activities are performed. The BEPS Action 13 report (Transfer Pricing Documentation and Country-by-Country Reporting) provides a template for MNEs to report annually and for each tax jurisdiction in which they do business the information set out therein.

²³ Article 5, paragraph 31, UCC.



The UCC-IA provides for a transitional measure to phase out the first sale rule known as the “grandfather clause,” which allows use of first sale for export until 31 December 2017. The grandfather clause may be used if the person on whose behalf the declaration is lodged is bound by a contract concluded prior to 18 January 2016. As the majority of the importers with multiple party supply chains currently make use of the grandfather clause, it is expected that the customs authorities will pay more attention to the application of the last sale rule as of 1 January 2018. In that respect, it is advisable to review the current supply chains prior to that date.

ECJ court cases: relevant developments and outlook

I. Recent court cases decided by the ECJ

GE Healthcare (C-173/15)

In the case of GE Healthcare (C-173/15),²⁴ GE Medical Systems Deutschland GmbH & Co. KG (GE Germany) concluded a standard-form license agreement with Monogram Licensing International Inc. (Monogram), both subsidiaries belonging to the General Electric group (the GE Group). The date on which royalties were due was set at 31 December of each calendar year. The royalties for the use of the GE trademark amounted to 0.95% of GE Germany’s annual turnover. GE Germany had acquired goods originating in third countries from subsidiaries belonging to the GE Group but had not declared the corresponding royalties paid to Monogram in the customs value declarations.

In that respect, the referring court asked whether the royalty payment related to the imported products and if yes, whether these payments should be included in the customs value even when it cannot be established, at the moment of importation, that royalties were owed and, in addition, take into account that the royalty payments are also paid for services. In that respect, it is important that, based on facts, the imported products could also be sold (royalty free) to related companies.

The ECJ ruled that the provisions in the CCC must be interpreted as not requiring the amount of royalties or license fees to be determined at the time when a license agreement was concluded or when the customs debt was incurred for those royalties or license fees to be regarded as related to the goods being valued. Furthermore, under the CCC, such royalties or license fees are considered to be “related to the goods being valued” even if those royalties or license fees relate only partly to those goods.

The decision of the ECJ also affects the provisions governing the inclusion of the royalty and license fees under the UCC. Importers are affected because, contrary to the understanding of some importers in the past, royalty payments could also be dutiable if the customs value is based on the importer’s purchase price and the royalty payment to the licensor is only due upon the sales of the importer. Further, as we have already discussed, royalty or license payments could still be dutiable if the amount of the royalty or license payment is not yet fixed at the time the goods are being imported. Therefore, in practice, it is advisable to align with the customs authorities and come to an understanding on how the royalty and license fees should be included in the customs value of the imported goods if the total amount of the royalty and license fee is calculated periodically, for example, at the end of the year.

Shirtmakers (C-59/16)

The Shirtmakers (C-59/16)²⁵ case deals with the scope of the concept of “cost of transport.” In principle, cost of transport, up to the place where goods are brought into the customs territory of the EU, should be included in the customs value of the imported goods.

Shirtmakers BV imported textile goods from Asia and entrusted the customs formalities to another company, which also organized the transport through various transport companies. For these services, the company charged fees to the importer, without making the distinction between its own fees and the actual costs of transport. The question was whether the supplements to the actual costs should be included in the customs value. In that respect, the ECJ ruled that the concept of “cost of transport” should be interpreted broadly.²⁶

²⁴ ECJ 9 March 2017, C-173/15, ECLI:EU:C:2017:195.

²⁵ ECJ 11 May 2017, C-59/16, ECLI:EU:C:2017:362.

²⁶ See, e.g., ECJ 6 June 1990, C-11/89, ECLI:EU:C:1990:237.



Therefore, the agent's profit margin and costs are also captured in the "cost of transport" and should be included in the customs value of the imported goods.

In *Shirtmakers'* view, the agent's costs should be treated as buying commission and should not be included as such in the customs value of the imported goods. According to the ECJ, this view is erroneous. Therefore, MNEs with a procurement company arranging the transportation on behalf of local EU distribution companies might be impacted. In that scenario, procurement fees might potentially be treated (partly) as main or incidental cost, incurred in connection with the movement of the goods, and constitute dutiable cost of transport.

II. Pending cases before the ECJ

X (C-661/15)

In the X (C-661/15)²⁷ case, the Advocate General (AG) has already delivered his Opinion. The questions at stake relate to the interpretation and validity of Article 145 of the Implementing Provision of the CCC (CCIP). This legal provision establishes the right to have customs duties reimbursed if the imported goods are damaged.

According to the AG Opinion, the restriction of the possibility to reimburse customs duties for damaged goods to one year is not in line with the "normal" three-year period²⁸ to reclaim unduly paid import duties. Therefore, Article 145, paragraph 3, of the CCIP should be declared invalid. If the ECJ follows the AG Opinion, the UCC will be affected as Article 132(c) UCC-IA also contains a time limitation of one year to reclaim import duties for damaged imported goods.

If the ECJ follows the position of the AG that the CCIP is partly invalid, the implications would be broader as such decision would provide some clarity about how far "lower" legislation (UCC-DA and UCC-IA) can change the scope of "higher" legislation (UCC). In the field of customs valuation, this may be relevant as some of the provisions in the UCC-IA (e.g., Article 128, which introduces the last sale rule) seem to change the scope of the UCC.

Hamamatsu Photonics Deutschland (C-529/16)

The Hamamatsu Photonics Deutschland (C-529/16)²⁹ case is a request for preliminary ruling concerning retroactive transfer pricing adjustments.

For decades, the question about the impact of retroactive transfer pricing adjustments has been fruit for thought in legal literature. Since EU legislation and guidance is lacking and the issue has not been brought up in court before the ECJ so far, the issue results in legal uncertainty. However, this may change in the near future as preliminary questions have been raised by the Finanzgericht München about whether the customs value can be based on a transfer price that is adjusted annually, and if this is a downward adjustment, whether this should lead to a refund of customs duties.

If the ECJ rules that the customs value can indeed be based on a transfer price that is adjusted annually, certain practical challenges may materialize for businesses importing goods into the customs territory of the EU. The new EU legislation does not provide for a specific scheme, such as the Reconciliation Program in the United States, to take into account retroactive transfer pricing adjustments for customs valuation purposes at the time the import declaration is filed.

²⁷ Opinion of Advocate General Saugmandsgaard ØE 30 March 2017, C-661/15, ECLI:EU:C:2017:252.

²⁸ The "normal" time limitation to lodge an application for repayment or remission is three years from the date of notification of the customs debt, see Article 121 UCC.

²⁹ Request for a preliminary ruling from the Finanzgericht München (Germany) lodged on 17 October 2016, C-529/16.



Under the Reconciliation Program, the importer is allowed to file a provisional entry summary and, at a later date, when the retroactive transfer pricing adjustments have been determined, file a reconciliation entry that provides the final and correct information.

The European Commission is currently examining how to contribute to the debate regarding transfer pricing arrangements from the viewpoint of customs and to consider the effects on customs practices. However, legislation or guidance is still lacking.³⁰ Also, there is no light at the end of the tunnel with respect to the evaluation and discussion on the need and relevance of introducing advance rulings (binding valuation information) in EU customs legislation.³¹ The binding valuation information could potentially provide prior consent from the customs authorities about if and how retroactive transfer pricing adjustments should be taken into account. However, currently, the UCC does not provide for the possibility to obtain binding valuation information and, therefore, practical measures should be examined on a case-by-case basis to ensure retroactive transfer pricing adjustments are taken into account in a proper way.

Look for more insight into UCC developments in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young LLP (United States)

Jeroen Scholten, *New York*
+1 347 493 6101
jeroen.scholten1@ey.com

Ernst & Young Belastingadviseurs LLP (the Netherlands)

Walter de Wit, *Amsterdam*
+31 88 40 71390
walter.de.wit@nl.ey.com

Martijn Schippers, *Rotterdam*
+31 88 40 79160
martijn.schippers@nl.ey.com

³⁰ Commission Implementing Decision of 17.2.2017 concerning the adoption of annual work programs for 2017 for the Customs 2020 and Fiscalis 2020 programs and on the financing of the programs for expenditure to be committed by DG Taxud from the 2017 budget lines 140201 and 140301, Brussels, 17.2.2017, C(2017) 826 final, p. 27.

³¹ This evaluation is also part of the annual work program for 2017 for the Customs 2020 and Fiscalis 2020 programs.

Gulf Cooperation Council

Saudi Arabian Tax Authority releases VAT Implementing Regulations for public consultation

GCC VAT law implementation in Saudi Arabia and the UAE

In the June 2017 issue of *TradeWatch*, we discussed the Gulf Cooperation Council's (GCC: Bahrain, Kuwait, Qatar, Saudi Arabia, Oman and the United Arab Emirates) plans to introduce value-added tax (VAT) aiming to diversify and increase their revenue base and reduce reliance on oil. We discussed the GCC VAT Framework Agreement, a broad framework instrument modeled after the EU VAT Directive,³² and described how it may apply to the importation of goods, as well as other business operations. The GCC member states are now in the process of adopting legislation to implement the Framework Agreement. Many of the VAT law provisions as adopted in Saudi Arabia and the United Arab Emirates are outlined in the articles below.

Saudi Arabia's Tax Authority, General Authority of Zakat and Tax (GAZT), recently released a draft bilingual (Arabic and English) version of the Value-added Tax (VAT) Implementing Regulations³³ (the Bylaw) on its portal for public consultation. With the official publication of the finalized VAT law in the Saudi Gazette, businesses should be able to assess their operations and prepare for the implementation of VAT on 1 January 2018.

Key provisions

Registration of small business units with GAZT

Small businesses with turnover below SAR1 million (approximately USD267,000) will be given an additional year to register with the GAZT, i.e., until 1 January 2019. This will enable smaller businesses to prepare and be VAT ready.

The Bylaw sets out the mandatory electronic registration requirements, which are expected to be open for VAT registrations beginning September 2017. This is notwithstanding that the GAZT has commenced the process for registering large businesses (revenues in excess of SAR40 million) (approximately USD10.7 million) and very large businesses (revenues in excess of SAR2 billion).

VAT grouping

If a group of companies shares common control (ownership control) of more than 50%, it will be considered for VAT grouping. The VAT grouping provisions of the Bylaw includes an anti-avoidance measure, whereby a VAT group may be set aside or disallowed if the main purpose of the group is to obtain a tax advantage. However, it will be difficult to reconcile this anti-avoidance measure with a taxpayer's or group of taxpayers' intentions regarding possible tax advantages. This is likely to give rise to potential tax litigation in the future.

³² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, p 1, 11 December 2006).

³³ Bilingual version (Arabic and English) of VAT Implementing regulations available at: <https://emeia.ey-vx.com/4040/90618/landing-pages/20170723-value-added-tax-implementing-regulations---bilingual-draft.pdf>.



Financial services supplies

Financial services supplies, including Islamic finance products, are exempt from VAT.

Consideration received for services rendered by banks by way of explicit fees, commission or commercial discount will be subject to VAT at the standard rate.

With respect of insurance services, life insurance is exempt, whereas general insurance is subject to the standard VAT rate.

Residential supplies

Residential real estate leasing or licensing (excluding hotels, inns, guesthouses, motels, serviced apartments or other temporary accommodation) is exempt from VAT.

Medical supplies

Qualifying medicines (list of medicines approved by the Ministry of Health) or medical goods (goods licensed by the Saudi Food and Drug Authority (SFDA)) dispensed to an individual for personal use on an authorized prescription are zero-rated, provided that such dispensing is carried out by a registered pharmacist, an SFDA-licensed distributor, a primary health care center or in a hospital.

Those supplies rendered earlier in the supply chain that do not adhere to these requirements will be taxable, i.e., only the supply to the individual recipient will be zero-rated or exempted.

Government authorities

Government authorities are not considered to be carrying on an economic activity and, therefore, are not required to register for VAT. However, if they are involved in the supply of goods and services in competition with the private sector, they would be considered to be carrying on an economic activity. In such instances, they will be required to be registered for VAT if they meet the threshold registration requirements. A government authority may apply for a certificate from the tax authority, which they can quote to the suppliers making the zero-rated supplies. Based on this, the government authority entity can also apply the reverse charge mechanism.

Transfer of going concern

In the case of a going concern, when an economic activity is transferred, it will not be subject to VAT, provided certain conditions are satisfied. This is a positive development considering that going-concern transactions are among the most disputed transactions in other VAT jurisdictions.

Imports

VAT due on imported goods will become payable at the time of entry. Certain exceptions may apply for imports, such as imports with value less than SAR10,000 (approximately USD2,600), certain imports of personal items and equipment for people with special needs (subject to certain limitations).



Importers may apply for authorization to make VAT payment on imports through their tax return instead of having VAT collected by the Customs Department upon entry.

Reverse charge mechanism

Taxpayers may adopt the reverse charge mechanism on the importation of goods into Saudi Arabia, provided that the taxpayer has a proven track record as a compliant taxpayer for the previous 12 months.

Method of VAT calculation

Taxpayers supplying used motor vehicles can adopt the profit margin method of VAT calculation.

Supply of vouchers

Supplies of vouchers are not subject to VAT where the consideration is equal to, or less than, the face value of the voucher.

Input tax credits

For acquisitions made up to six months before registration, special rules need to be applied for claiming input tax credits.

Input tax credits may not be deducted for:

- ▶ Entertainment, sporting or cultural events
- ▶ Catering services in hotels, restaurants and similar venues
- ▶ Purchase or lease of motor vehicles used or made available for private use (restricted motor vehicles) and any costs associated with restricted motor vehicles, and any other private or non-business goods or services

Special rules apply for claiming input tax credits for acquisitions made up to six months before registration.

Deduction methodology

The proportional deduction for non-direct attributed acquisitions is based on the taxable sales of the previous calendar year divided by total sales for the same period. Capital assets are excluded from the above calculation. Adjustments need to be made in the final tax return when the actual amounts are known. Taxpayers may also apply for alternative methods; however, the de minimus rule is not available.

Capital assets

The adjustment period for deduction of input tax credits in relation to change in the use of capital assets is six years for tangible or intangible capital assets and ten years in respect of immovable capital assets or the useful life of the capital asset where it is less than the six or ten years. Such adjustments are required every 12 months.

Tax invoices

Tax invoices must be issued by the 15th day of the month following the month of taxable event. It is anticipated that this is likely to create problems when suppliers delay the issuance of tax invoices.

The VAT amount payable (in Saudi riyals) is required to be shown in Arabic. The Tax Identification Number (TIN) of the customer need not be shown in the tax invoice. The simplified tax invoice requirements include stating the tax payable or the amount inclusive of tax.

Debit and credit notes

The requirements for debit and credit notes are detailed in the Bylaw. Debit and credit notes must include reference to the sequential number of the tax invoice.



Details of the tax return

A tax return should include the following details:

- ▶ Total value of taxable supplies and zero-rated supplies
- ▶ Total acquisitions
- ▶ Total deductible input tax
- ▶ Total value of nominal supplies
- ▶ Total value of supplies subject to the reverse charge mechanism
- ▶ Total value of internal supplies
- ▶ Total tax on imports
- ▶ Total value of exempt supplies
- ▶ Other supplies
- ▶ Value of adjustments (proportional deduction of input tax)
- ▶ Adjustment made on the change of use of capital assets
- ▶ Corrections related to previous returns

It is likely that this extensive list of required disclosures will prove to be a challenge to incorporate or implement taking into consideration the required number of tax codes and general ledger codes.

Amendment of tax return

Errors greater than SAR5,000 (approximately USD1,300) require the previous tax return to be amended. Where tax evasion or intentional breaching of provisions is found, the limitation period for amendment of assessment can range up to 20 years.

Tax records

Records must be kept for six years from the end of the tax period, and, in relation to capital assets, these must be maintained for a six- or ten-year period, as the case may be, plus five years.

Grandfathering provisions

In the case of grandfathering provisions for contracts, the customer must certify that it is able to claim the input tax in full. An application to the tax authority is not required in this respect, and the regulation does not stipulate any minimum value for these contracts.

Note: The above comments are based on the draft version of the Bylaw (based on unofficial translations) and likely to be subject to change.

Next steps

The GAZT is conducting various sessions to actively engage with business groups to increase awareness on the proposed VAT and its impact on their businesses. It is imperative for importers and other businesses operating in the GCC region to take immediate steps to become compliant with the respective GCC member state's VAT laws.

GCC businesses should initiate a VAT impact assessment immediately to determine the impact of VAT across their operations. This assessment should consider the VAT impact on the following key areas:

- ▶ Finance and accounting IT and systems
- ▶ Tax and compliance
- ▶ Supply chain - goods and services
- ▶ Contracts
- ▶ Sales and marketing
- ▶ Legal structure
- ▶ Human resources

The impact assessment should be used to develop a clear plan detailing the steps that must be taken to be ready for the VAT go-live date of 1 January 2018.

Look for updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young Middle East (United Arab Emirates)

David Stevens, *Dubai*
+971 4 332 4000
david.stevens@ae.ey.com

Michael Hendroff, *Dubai*
+971 4 332 4000
michael.hendroff@ae.ey.com

Ernst & Young Middle East (Saudi Arabia)

Amr Farouk, *Riyadh*
+966 11 215 9898
amr.farouk@sa.ey.com

Ahmed Hassanin, *Riyadh*
+966 11 273 4740
ahmed.hassanin@sa.ey.com

Sujit Narayanan, *Riyadh*
+966 11 214 6902
sujit.narayanan@xe04.ey.com

Rolf Winand, *Jeddah*
+966 2 221 8400
rolf.winand@sa.ey.com

UAE Government publishes new VAT Law



The United Arab Emirates (UAE) Federal Government has approved the Value-added Tax (VAT) Law³⁴ (the Law) and published the statute on 27 August 2017.

The highlights of the Law are described below.

Effective date of implementation

Article 85 provides that the Law shall be effective from 1 January 2018.

Scope of levy

Article 2 provides that all taxable supplies (including deemed supplies) as well as imported concerned goods shall be subject to VAT. The term “concerned goods” is defined as imported goods that would not be exempted if they had been supplied in the UAE. The VAT treatment of concerned goods will be regulated by the Executive Regulations.

Tax rates

Article 3 provides that a standard rate of 5% will be imposed on the supply of goods and services, as well as importation. There are, however, certain exceptions where the zero-rate will apply, as well as exemptions.

Registration

UAE residents are, under Article 13, required to register for VAT if the value of goods and services supplied exceeds (or is expected to exceed) the registration threshold to be specified in the Executive Regulations. Persons (this includes both individuals and legal entities) without residency in a Gulf Cooperation Council Member State where VAT will be implemented will be required to register for VAT if they supply goods or services in the UAE and no other person is required to account for VAT in respect of those supplies. A person may apply to the tax authority to be exempted from the VAT registration requirement if the person only makes zero-rated supplies.

A person may voluntarily register for VAT under Article 17 if the voluntary registration threshold per the Executive Regulations is exceeded or expected to be exceeded in a 12-month period.

Two or more persons conducting business in the UAE may register as a “Tax Group” if the parties are related, each entity has a place of establishment in the UAE, and the parties are subject to common control.

³⁴ Federal Decree Law No. (8) of 2017 on Value Added Tax. Official version in Arabic available at: <https://www.mof.gov.ae/ar/lawsandpolitics/govlaws/pages/vat-law.aspx>. Unofficial translation into English available at: <https://www.mof.gov.ae/en/lawsandpolitics/govlaws/pages/vat-law.aspx>.



Supplies between related parties

The value of supplies between related parties is deemed to be the market value of the supply if less than market value was charged and the recipient would not have been entitled to full input tax recovery.

Advertising

Advertised prices must include VAT unless conditions of the Executive Regulations are met.

Zero-rated supplies

The Law sets forth 14 instances where supplies may qualify for zero-rating, including exports, international transport, investment metals, first supply of residential buildings (provided it is supplied within three years of completion), crude oil and gas. Educational services as well as preventative and basic health care services and related goods and services may also be zero-rated if compliant with the specifications in the Executive Regulations.

Free-trade zones

Designated free-trade zones are deemed to be outside the UAE. Goods may be transferred between designated zones without VAT. The Executive Regulations will specify the applicable procedures and conditions.

Exempt supplies

The supply of bare land, local passenger transport, and the sale and lease of residential buildings will be exempt from VAT, as well as financial services specified in the Executive Regulations.

Tax invoices

Tax invoices must be issued within 14 days from the date of supply. In instances where the value of the supply is in a currency other than UAE dirham (AED), the amount must be converted to AED using the exchange rate approved by the Central Bank at the date of supply.

Irrecoverable debts

A VAT registered person may reduce output tax in the tax period that an irrecoverable debt is written off if VAT was charged and paid when the goods or services were supplied and more than six months has passed from the date of supply, provided the supplier notifies the recipient of the amount written off.

The Law refers to the Executive Regulations, which will provide more specific guidance on:

- ▶ VAT registration thresholds
- ▶ Specific place of supply rules
- ▶ Profit margin scheme
- ▶ Conditions and obligations in respect of the reverse charge mechanism
- ▶ Defining designated zones
- ▶ Exempt financial services
- ▶ Content of tax invoices
- ▶ Content and form of tax return, including conditions thereof
- ▶ Adjustments to tax invoices and tax returns
- ▶ Tax periods
- ▶ Apportionment
- ▶ Capital assets scheme
- ▶ Payment of tax and other dues relating to VAT
- ▶ Transitional provisions where a contract was concluded on or before 31 December 2017 but the supply under the contract is made wholly or partly on or after 1 January 2018

The original Law is published in Arabic. In the case of a conflict between the original version (Arabic) and any translation, the Arabic version will prevail.



Next steps

The approval and publication of the Law mandate that businesses must be ready to account for VAT from 1 January 2018. This leaves businesses with four months to prepare for VAT, which, for large businesses, represents a significant challenge. Although many large businesses have initiated studies to determine the impact of VAT on their operations, there is still a large section of the business community waiting for the enactment of the Law in order to commit financial budgets for VAT-readiness projects. Given the very short time frame to achieve VAT readiness, it is important that all businesses initiate a VAT impact assessment immediately in order to determine the impact of VAT across their operations. This assessment should consider the VAT impact on the following key areas:

- ▶ Finance and accounting
- ▶ IT and systems
- ▶ Tax and compliance
- ▶ Supply chain – goods and services
- ▶ Contracts
- ▶ Sales and marketing
- ▶ Legal structure
- ▶ Human resources

The impact assessment should be used to develop a clear plan on the steps that must be taken to be ready for VAT by the effective date of 1 January 2018.

For additional information, contact:

Ernst & Young Middle East (United Arab Emirates)

David Stevens, *Dubai*
+971 4 332 4000
david.stevens@ae.ey.com

Richard Dearing, *Dubai*
+971 4 701 0883
richard.dearing@ae.ey.com

Sana Azam, *Abu Dhabi*
+971 2 417 4562
sana.azam@ae.ey.com

James Bryson, *Abu Dhabi*
+971 2 417 4400
james.bryson@ae.ey.com

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ey.com

***TradeWatch* contacts:**

Americas

Bill Methenitis, *Dallas*
Ernst & Young LLP (United States of America)
+1 214 969 8585
william.methenitis@ey.com

Asia-Pacific

Adrian Ball, *Singapore*
Ernst & Young Solutions LLP (Singapore)
+65 6309 8787
adrian.r.ball@sg.ey.com

Europe, Middle East and Africa

Franky De Pril, *Diagem (Brussels)*
Ernst & Young Tax Consultants BCVBA (Belgium)
+32 2 774 9484
franky.de.pril@be.ey.com

***TradeWatch* Editor**

Azalea Rosholt, *Abu Dhabi*
Ernst & Young Middle East (United Arab Emirates)
+971 2 417 4400, ext. 216
azalea.rosholt@ae.ey.com