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Economic Partnership Agreement (EPA) between the EU and Japan entered into force

On 20 December 2018, the EU Council approved the Economic Partnership Agreement (EPA) between the EU and Japan; as Japan had previously completed its ratification process on 8 December, the agreement became effective 1 February 2019.

With the EPA in place, more than 90% of Japanese customs duties will ultimately be removed for imports of goods with EU preferential origin. Vice versa, more than 97% of EU customs duties will be removed upon imports of goods with Japanese preferential origin into the EU. Also, the EPA will enable access to some highly regulated Japanese markets.

The EPA is more than a regular free trade agreement, as the agreement will not only lead to duty free trade but will also address multiple non-tariff matters such as reduced/removed regulatory barriers.

Trade in goods

Tariffs on most goods traded between the EU and Japan will be gradually eliminated by the EPA. The EU and Japan will both eliminate all tariffs on industrial products and most tariffs on agricultural products. Most tariffs that are scheduled for elimination were removed immediately following the agreement's entry into force in February 2019, with the remainder to be gradually phased out over the next several years.

EU goods that will eventually be eligible for duty-free import into Japan under the agreement include dairy products, such as cheese and butter; meat products, such as pork, beef and poultry; and wine. The tariff reduction schedules for these products vary; for instance, duties on wine were removed immediately following the EPA's entry into force. Other major categories subject to liberalization of import duties, either immediate or gradual, include chemicals, plastics, cosmetics, textiles and apparel.

For Japanese exports to the EU, the main beneficiary of the agreement is likely to be the automotive industry. While the EU currently imposes customs duties of 10% on motor vehicles, depending on the specific type, these will be eliminated gradually in eight equal annual installments. Other major sectors for which trade will be liberalized are machinery, electronics, precision instruments, textiles and chemicals.

Trade in services

The EU–Japan EPA also provides for the reciprocal liberalization of trade in services and investment, and for cooperation on electronic commerce. It is expected that businesses trading in financial services, telecoms services, postal and courier services, computer/information services, travel and air transportation services will benefit from the EU–Japan EPA.

Removal of regulatory barriers

Non-tariffs barriers are addressed by the EU–Japan EPA as well, which facilitates the access of EU companies to the highly regulated Japanese market and the other way around. These non-tariff barriers concern, among others, motor vehicles, medical

devices, textile labelling, cosmetics and beers. The EU-Japan EPA will also protect more than 200 European agricultural products from a specific geographical origin, also known as Geographical Indications (GIs). This will allow European products on the Japanese market to have the same level of protection.

Preferential origin

The EU-Japan EPA provides reciprocal and mutually advantageous benefits for companies involved in trade between the EU and Japan. To make use of these benefits – i.e., elimination of tariffs on goods – three main conditions should be fulfilled:

1. Goods shipped between the EU and Japan must meet the EPA preferential rules of origin.
2. The goods should be directly shipped from the EU to Japan or vice versa.
3. The importer should have a statement on origin or "knowledge" of the origin.

Under the rules on origin as agreed between the EU and Japan in the EPA, a good shall be considered as having Japanese/EU preferential origin if the good is:

- A wholly obtained product or produced from wholly obtained Japanese/EU products (such as products obtained via harvesting, mining or fishing)
- A product produced exclusively from materials originating in Japan/EU
- A product produced using non-originating materials, provided they satisfy all applicable requirements of Annex 3-B of the EPA. This annex contains the product-specific origin rules. Generally, this means the products must have had sufficient working or processing in Japan/EU, going beyond the simple assembly of non-Japanese/non-EU products.

As with many other free trade agreements, the EPA contains a direct transport rule under which preferential origin can only be maintained if the goods are directly transported between the EU and Japan (or vice versa). Storage of a product may take place in a third country (not being Japan or the EU) if it remains under customs supervision in that third country. Also, the splitting of consignments may take place in a third country if it is carried out by the exporter or under its responsibility, and if they remain under customs supervision in that third country.

Compared to previous EU free trade agreements, the EPA provides new simplified procedures for proving preferential origin that provide flexibility for importers to claim preferential tariff treatment. As such, importers can base their claim on:

a) **A statement on origin**
A statement on origin is prepared by the exporter or the manufacturers and is based on information demonstrating that the product is originating or that the materials used in production are originating. The statement can be printed on the invoice or on other commercial documents and is valid for 12 months. The exporter is responsible for the correctness of the statement and the provided information. A statement on origin may apply to a single shipment or to multiple shipments of identical goods within a year after the statement was prepared.

b) **The importer's knowledge that a product is originating**
The EPA also provides for the possibility to claim a preferential duty rate when the importer has sufficient "knowledge" that a product is originating. This knowledge should be based on information (mostly provided by the exporter or manufacturers) demonstrating that the product satisfies the requirements to obtain the preferential origin.

For *EU exporters* who want to print origin statements on invoices or other commercial documents, a registration as registered exporter (REX) is required if the consignments have a value of more than EUR6,000. Below this threshold, a REX registration is not required.

Japanese importers who wish to claim EPA benefits are required to provide documents that outline how goods meet the rules of origin at the time of importation. Those declaring based on a statement on origin issued by the exporter should submit the invoice for the goods with the statement on origin and a completed Customs Form C-5293[1]. Those declaring based on the importer's knowledge should submit a Customs Form C-5292 instead of the invoice with the statement on origin, in addition to submitting Form C-5293.

While Form C-5293 includes a field for details regarding how the imported goods meet the applicable rules of origin, importers who do not have access to this information (e.g., those claiming originating status based on an exporter's statement on origin without access to manufacturer's trade secrets) may indicate so on the form and still apply the EPA duty rate at the time of importation. Japan Customs issued a notice[2] on 17 July 2019, announcing a relaxation of this rule. Importers who cannot submit Form C-5293 (for example, because they are relying on an exporter's statement on origin) are no longer required to provide the reason why this is not possible. In addition, as of 1 August 2019, such importers no longer need to submit Form C-5293 and instead may type the following text in the text field of the electronic import declaration filed through NACCS[3]: "I cannot provide an additional explanation on the originating status of the product." After 1 December 2019, the NACCS system will be updated, and importers will instead insert a predetermined code into the electronic import declaration (the details will be announced later).

It should be noted that importers certifying origin based on the importer's knowledge should have already obtained information that demonstrates that the product is originating at the time of import declaration and therefore should be able to submit Form C-5293.

The EPA allows the importer to prove preferential origin based on their own knowledge of the purchased products. We note that this, in principle, comes down to the information shared by the exporter or manufacturers. Therefore, if the exporter is not willing to share much (commercial) information about the products, it can be difficult for the importer to have sufficient information to prove the preferential origin of the goods. In that situation, an origin statement from the exporter would still be necessary. In practice, we therefore think this possibility of certification through the "importer's knowledge" will be mainly used by affiliated companies.

Retroactive application on preferential duty rate in the EU

Dutch customs authorities have published a news alert on 13 May 2019 in which they advise that retroactively claiming preferential origin will be allowed through a request of repayment of import duties. However, they note that this is subject to one reservation. The European Commission still needs to give its final approval to this practice. If the European Commission does not approve, the Dutch authorities will have the right to claim back the import duties refunded.

1 Importers may substitute other documents for Customs Forms C-5292 and C-5293 provided that they contain equivalent information.

2 http://www.customs.go.jp/roo/english/text/eu-3-16e.htm

3 NACCS (abbreviation for Nippon Automated Cargo and Port Consolidated System) is a system for online processing of procedures taken with Japan Customs.

Take away for businesses

Businesses using the EU-Japan EPA should assess whether their goods subject to export from the EU to Japan or vice versa are eligible for preferential origin under the detailed origin rules of the EPA. Furthermore, these businesses should identify the different stakeholders for origin management in their supply chain set-up, for example, specifying that the exporter or manufacturers are required to print the origin statements, and safeguarding that sufficient information is available to prove that the preferential origin requirements are met. ■

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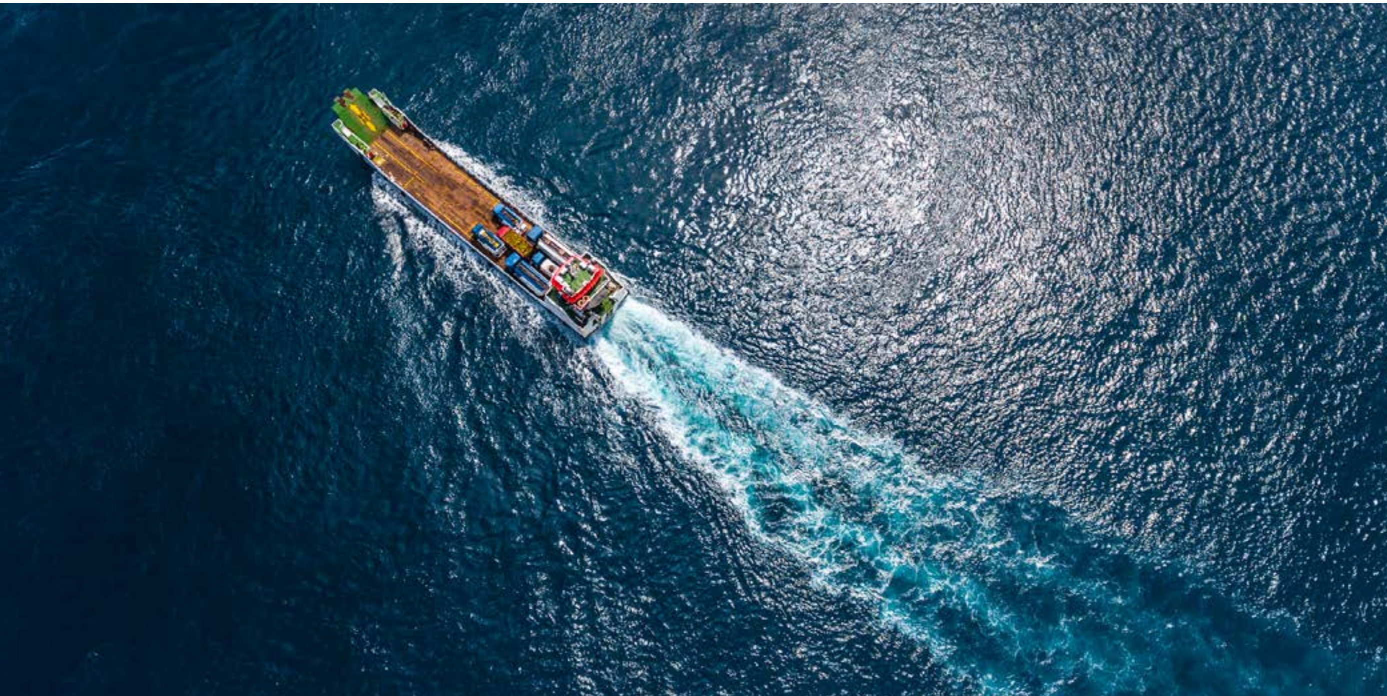
Focusing on fundamentals — a global trade leading practices briefing

EY teams recently conducted a Global Trade Focus day titled "Focusing on fundamentals." This event was the latest in a series of roundtable discussions among a group of distinguished and experienced global trade professionals. The 2019 discussion continued to build upon topics covered in the 2018 symposium and resulted in the EY publication, "Is trade the disruptor or disrupted?"

Since the 2018 event, significant trade disruption continues, namely the release of the text of the new North American Free Trade Agreement (NAFTA), otherwise known as the US Mexico Canada Agreement (USMCA); continued BREXIT uncertainty; material sanctions on companies, countries, and persons in Russia, China, and Iran; and the imposition of duties under Section 301 of the Trade Act of 1974 by the US on Chinese-origin goods and related Chinese retaliatory duties. Not surprisingly, 301 and China dominated the conversation at this year's roundtable based on the significance of the impact and the widespread nature of industries impacted.



The 2019 Global Trade Focus day revealed that the added pressures of disruption had not changed significantly since the 2018 symposium, but because of the sustained release of new measures month-by-month, the views expressed by the participating global trade professionals demonstrate that they are more convinced that trade disruption will not subside in the short run but remain uncertain on how long it will last. Global trade executives cited the US 301 tariff actions with Chinese-origin goods as the main driver for trade disruption.

In this current environment, global trade professionals expressed the need to continue looking for ways to balance "fighting fires" while executing strategic, value-added initiatives. While some global trade executives are taking the approach of "keeping calm but trading on," the discussions determined that the overwhelming majority of global trade executives are embracing the disruption and using the enhanced corporate visibility and attention as a platform to improve and bolster the global trade function.

When the additional 25% duties were initially incurred as the lists of Section 301 subject goods rolled out, and as they await the 5% increase signaled for 1 October, along with the now imposed List 4A on 1 September and pending List 4B on 15 December, global trade executives expressed that they have been able to leverage their seat at the table with other functions within the company to more swiftly implement projects with strong returns on investment (ROI), such as foreign trade zones or bonded warehouses.

Similarly, internal relationships with procurement, supply chain and customer service have enabled collaboration with third-party suppliers and customers to review contracts, better understand integrated supply chains and revisit Incoterms, for example. In addition, global trade functions that have focused on data — data availability, data consistency and data quality — were much better equipped to analyze the impact of disruption — BREXIT, USMCA, new agreements section 232 or Section 301 in a timely manner. Further, access to data and improved data analytics tools have enabled global trade executives to respond to the multitude and frequent requests from all areas within the company, including C-suite executives, with a meaningful impact analysis and in some cases, planning options.

However, global trade executives also acknowledged that the speed and complexity of trade disruption has also resulted in the need to return to the basic foundational skill sets of classification, origin and valuation. It was in the return to these fundamental principles where global trade executives were able to again demonstrate the creativity and value of the function. Thus, global trade executives found results by devoting time: to re-examine the accuracy of classifications and work with third parties to demonstrate that a more favorable duty rate does not necessitate a change in the classification without support, to demonstrate that a shift in supply chain could result in a different origin or to lawfully exclude certain elements in the declared value to result in a lower dutiable value.

The Focus Day report concluded that global trade executives responded to the call to "keep calm and trade on," while navigating the disruption by leveraging the strong foundations they established in their global trade functions and revisiting basic skills.

To read the full report, click here. ■

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Free trade agreement negotiations between Mercosur and the EU concluded

A free trade agreement (FTA) between Mercosur (Argentina, Brazil, Paraguay and Uruguay) and the European Union (EU) would eliminate import duties on more than 90% of the products traded between the blocs and establish preferential import quotas with reduced rates for products that would be subject to tariffs. Some of the highlights of the new FTA are discussed below.

After 20 years of negotiations, Mercosur and the EU have agreed on an FTA that will comprise one of the largest free trade areas in the world and would reduce the import duties on a list of goods that includes agricultural and industrialized products. This FTA is a milestone in the relationship between the two economic blocs, which represent about 25% of the world's gross domestic product, within a market of nearly 780 million people.

Practical scenario of the elimination of import duties arising from the agreement

The FTA will provide the elimination of tariffs, quotas and partial tariff reductions for many products from different sectors. This is expected to happen gradually over the next years. The products to be highlighted here are mainly from the agricultural sector (from roasted coffee to honey) and the automotive business (from cars to auto parts).

The EU will eliminate duties on 92% of goods (it is 24% today), including 100% reduction for industrialized products and an 82% reduction for agricultural products. MERCOSUR, on the other hand, will liberalize 91% of its imports from the EU. This entire liberalization process shall take place gradually within the next 10-15 years.

Rules of origin

As with the majority of FTAs, this one will also embrace rules of origin, which help to sustain local manufacturing and/or substantial transformation within the exporter's country — where one of the biggest benefits will be for local economies, besides the increase of exports. For such origin rules, there shall be a differentiation between the rules according to the product type.

Many rules of origin are very similar to the ones previously established for the countries within MERCOSUR, however, some additional clarification of important topics was provided. As this FTA deals with a high volume of products and a high percentage of duty elimination, additional details over the rules of origin are necessary.

To provide more details, we have set out 10 different scenarios, and their prevailing treatment as per the Agreement:

1. Origin of products considered as originating in the EU

a) Products wholly obtained in the European Union within the meaning of Article 4;

b) Products obtained in the European Union exclusively from originating materials;

c) Products obtained in the European Union incorporating non-originating materials provided they have fulfilled the conditions set out in Annex II (product-specific rules)

2. Origin of products considered as originating in the MERCOSUR

a) Products wholly obtained in Mercosur within the meaning of Article 4;

b) Products obtained in Mercosur exclusively from originating materials;

c) Products obtained in Mercosur incorporating non-originating materials provided they have fulfilled the conditions set out in Annex II (product specific rules)

3. Origin qualified by bilateral cumulation

Goods originating in the European Union shall be considered as goods originating in Mercosur when incorporated into a product obtained there, provided they have undergone working or processing going beyond the minimum operations in Article 6 of the Agreement. This will also be the case for goods originating in MERCOSUR, which shall also be considered originating in the European Union.

4. Wholly obtained products

Within the definition of wholly obtained groups, are those products that were raised or even grown within the territory of the country-members of the FTA. Those products are from mineral products of living and non-living natural resources, to vegetables and live animals.

5. Unit of qualification

a) When a product composed of a group or assembly of articles is classified under the terms of the Harmonized System in a single heading, the whole constitutes the unit of qualification; and

b) When a consignment consists of a number of identical products classified under the same heading of the Harmonized System, each product must be taken individually when applying the provisions of this Protocol.

6. Packaging materials

Where, under General Rule 5 of the Harmonized System, packaging is included with the product for classification purposes, it shall be included for the purposes of determining origin. Also, packing materials and containers for shipment that are used to protect products during transportation shall be disregarded in determining the origin of that product.

7. Accounting segregation

Companies that are aiming to be a beneficiary of the FTA must analyze the fact that additional controls, beyond the establishment of rules of origin are needed, such as the physical segregation of fungible products according to their origin, which means that if a product was purchased by the benefits of the FTA and the same item was also purchased without the benefits of the FTA, they must not be stored together.

8. Sets

Sets, as defined in General Rule 3 of the Harmonized System, shall be regarded as originating when all component products are originating. Nevertheless, when a set is composed of originating and non-originating products, the set as a whole shall be regarded as originating, provided that the value of the non-originating products does not exceed 15% of the ex-works price of the set.

9. Neutral elements

Energy, fuel, plant and equipment, machinery and tools and other items that do not enter or are not intended to enter into the final composition of the product do not harm nor benefit the origin criteria.

10. Product-specific rules

Product-specific origin rules have been published by the EU Commission. The Commission emphasizes that the texts are published for information purposes only and may undergo further modifications including as a result of the process of legal revision. The text of these provisional origin rules can be found online here.

The treatment related to insufficient working or processing operations is clearly defined, with 17 operations involving processes such as simple mixing of products to changes of packaging.

Administrative procedures

In the EU, exporters must register in the REX system to be able to issue such statements. Regarding verification, customs authorities of the importing party may request administrative cooperation to obtain information from the exporting party.

In MERCOSUR, exporters must provide the proof of origin to an authorized organization that will be responsible to issue the origin certificates whenever items are being commercialized.

Each country within the FTA should be aware of its local legislation toward the deadlines to recurrently update the proof of origin of its goods, in order to maintain the compliance of its origin certificates.

Nevertheless, for Brazilian companies, the special regimes such as the Drawback, RECOF and others arising from the export processes of manufactured goods will remain active, even with operations of covered products for this FTA. Zona Franca or free trade zones are not yet addressed within the discussions.

Opportunities

According to the EU, the FTA creates opportunities for the agricultural and food sectors, while at the same time mitigating possible market pressures. The EU will have unprecedented access to the Mercosur countries, which represent a large market of 260 million people through the planned tariff treatments. In return, Mercosur consumers will gain easier access to certain high-end EU products.

Conversely, the FTA guarantees the right of Mercosur and the EU to adopt WTO trade defense measures (anti-dumping, countervailing measures and global safeguards) bilaterally, i.e., each country may use safeguards to protect themselves from import surges arising from the liberalization process. Also, a modernization of rules of origin shall be expected to differentiate and respect the benefits each country is looking for within each sector of products covered by the FTA. These defensive measures may also be discussed with the main local industries and producers, which shall be a highly time-consuming activity to embrace the interests from the locals and the diplomatic relationship that Member Countries of the deal are becoming a part of.

One example of the potential conflicts are the arguments provided by Copa Cogeca, a group that represents farmers in the EU: "Agriculture has been the trade-off chapter to facilitate gains in other sectors." The agricultural sector in the EU has been shown to be generally skeptical of the FTA and this may create a political obstacle to ratification.

Similar pronunciations have been observed from the politicians of Argentina, such as Alberto Fernández, running to be Argentina's president this year: "It is not clear what the concrete benefits are for our country. But it is clear what the damage for our industry and Argentine employment would be [...] An agreement like that is nothing to celebrate but provides plenty of reasons to worry."

Next steps

The FTA between Mercosur and the EU does not apply yet. Negotiations have ended successfully; however, the text is being revised by the legal teams of the two economic blocs. The document should then be submitted for approval by parliaments of all signatory countries for ratification, which should take about two years.

To prepare for the FTA's entry into force, businesses should assess and analyze their supply chains with a particular focus on the new rules of origin. Businesses may also consider alternatives to leverage their presence in the Mercosur and EU countries. For example, importing a product from a manufacturer in Mercosur or the EU, instead of from another country without an FTA, could make the supply chain more effective and, consequently, become a much more competitive product in the market. Nevertheless, it is important to analyze the terms of the FTA to verify all products on which the concessions were made, as there shall be specific rules to be met, depending on the products and sectors being manufactured and commercialized. ■

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Developments on the path towards USMCA ratification

NAFTA entered into force on 1 January 1994 and created one of the world's largest free-trade areas.

NAFTA created a regional market of 480 million people, with a combined gross domestic product (GDP) of more than US$20t North America (Canada, US and Mexico) exports US$2.3t in goods worldwide, rep- resenting 18% of global exports.[1]

NAFTA renegotiation

In August 2017, all three countries agreed that NAFTA should be renegotiated, but the focus of each country in the negotiations was different.

From the US perspective, the focus was mainly based on trade imbalance and the loss of manufacturing jobs.

Canada, on the other hand, agreed to renegotiate NAFTA but focusing on other objectives, such as protecting NAFTA's record as an engine for job creation and growth, modernizing the agreement, cutting red tape for business and harmonizing regulations — measures that are all aimed at making NAFTA more progressive, particularly with respect to labor, the environment and gender.[2]

Mexico's objectives were similar to Canada's. Specifically, Mexico aimed at having more, not less, trade, strengthening North American competitiveness, advancing toward more inclusive regional trade, taking advantage of the 21st century economy to embrace innovation and promoting certainty for trade and investment in North America, among others.[3]

Agreement and ratification process of the USMCA

The evident discrepancies between the NAFTA objectives of the US, Mexico and Canada created a complicated renegotiation process.

Nonetheless, on 1 October 2018, the United States (US) president announced a preliminary agreement with Canada to revise the terms of the existing North American Free Trade Agreement (NAFTA) between the US, Mexico and Canada. The United States Trade Representative (USTR) subsequently published the full text of the proposed agreement on 1 October 2018, which was named the United States–Mexico–Canada Agreement (USMCA), and released details on how the USMCA will achieve stated objectives to modernize previous commitments made under NAFTA, including major changes to trade in agricultural products, auto-mobiles and automotive parts and textiles; increased thresholds for low-value (de minimis) shipments subject to informal entry procedures; enhanced data protection for biologic drugs; and other provisions.

The USMCA was subsequently signed 30 November 2018 by US President Trump, Mexico's President Peña Nieto and Canada's Prime Minister Trudeau

1 Information provided by Mexico's Secretary of Economy, with data from the International Monetary Fund (IMF) and the World Trade Organization (WTO).

2 As stated by Canadian Minister of Foreign Affairs Chrystia Freeland at the opening conference of the renegotiation rounds.

3 As stated by Mexico's then Secretary of Economy, Ildefonso Guajardo.

during the G-20 meeting in Buenos Aires, Argentina. As such agreement requires ratification by all three countries, each of these proceeded with such process as described below.

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Mexico

In Mexico, the USMCA was promptly submitted by now President Andrés Manuel López Obrador to the Senate and revised by the "Foreign Relations Ordinary Commission" to be considered and ratified. A two- thirds majority of the Mexican Senate voted in favor of the agreement which was ratified on 19 June 2019.

Canada

After signing the USMCA at the G-20 in Buenos Aires, Prime Minster [Justin] Trudeau introduced Bill C-100, an Act to implement the Agreement between Canada, the United States of America and the United Mexican States, in Canada's House of Commons on 29 May 2019. As Prime Minister Trudeau's Liberal government, as well as the opposition Conservatives, are largely in favor of the USMCA, Bill C-100 sailed through its second reading on 20 June 2019, before Parliament went into summer recess. The bill is currently under consideration by the Standing Committee on International Trade, as is common procedure before Members of Parliament can propose amendments. Following an eventual third reading, the bill is normally tabled in the Senate for further consideration.

However, with the upcoming 21 October 2019 Federal Election, it not clear that Canada would be able to ratify the USMCA by the last sitting day of Canada's 42nd Parliament. If it does not pass in the Senate by 15 September 2019, then Bill C-100 will "die on the order paper," in poignant parliamentary jargon. It could then be reintroduced in the next Parliament, which may very well happen if the incumbent Prime Minister Trudeau and the Liberal Party of Canada form the government. However, it is unclear how much support the bill would enjoy if the Conservative Party, currently polling neck and neck with the Liberals, is elected into government. Though the Conservatives are generally speaking strong supporters of free trade with the United States, the Conservative Party leader, Andrew Scheer, has been critical of USMCA in recent past, calling the deal a "failure."

United States

In the United States, once the agreement is signed by the president, an implementing bill must be submitted for Congressional approval. Once the implementing bill is introduced, Congress has a maximum of 90 days in session to enact it. Under TPA rules, the bill is subject to a simple yes or no majority vote, which means that amendments are not allowed to the text of the agreement. Several hurdles are being faced as the Democratic majority in Congress is particularly questioning the USMCA provisions related to labor, environment, enforcement and biologics provisions. The current administration is expecting such differences to be resolved by Congressional action during the current month, but uncertainty still prevails.

Conclusion

Once the agreement is ratified by the legislatures of the US and Canada, the USMCA will enter into force no sooner than three months from the date of the last country's notice. Therefore, for the USMCA to enter into force on 1 January 2020, as was originally planned, the US and Canada must ratify the Agreement before 1 October 2019.

Ecuadorian Customs Authority enacts new regulations to apply or renew as an AEO

In Ecuador, an Authorized Economic Operator is the person involved in the international movement of goods that complies with all security measures for the logistics chain, such as: manufacturers, importers, exporters, carriers, consolidators, dis-consolidators, international freight agents, ports, airports, customs warehouses, temporary warehouses, courier, terminal operators.

In August 2019, the Customs Authority enacted new regulations to apply for the AEO qualification. The process is free (no charge), voluntary and under the veracity responsibility of the applicant regarding the information and documents filed for the qualification.

Applicants who failed to be AEO will not change its current relation with the Customs Authority and it is not a condition to operate international freight traffic.

The process for AEO is subject to a validation process in two phases: (i) satisfactory record and (ii) financial solvency. The first one intends to evidence that the applicant is an ideal economic operator in its commercial transactions and customs operations. The applicant must demonstrate an excellent behavior, lawful origin of funds, no debts, duly tax compliance, no judicial judgments for customs contraventions and no transactions with "shell" (phantom) companies. The second condition consists in evidencing economic solvency through external audit report and financial statements up to date.

The qualification process starts with the online form presented before the Customs Authority that will have 10 business days to review the compliance of general conditions. The applicant will be granted with 15 days to prepare and present all documents evidencing phases (i) and (ii) as previously detailed (all documents are kept as confidential in the Customs Authority file). The Customs Authority will have 60 business days to issue a compliance report and grant the AEO qualification through administrative resolution.

AEO qualification will be granted for three years (subject to renewal). During such period, the economic operator can access to benefits in the customs transactions, as follows: local and international recognition as an Economic Operator with security measures to minimize risks, non-intrusive coordinated control, reduction on inspections and review to import documentation,

priority attention, training and to use a distinctive mark recognized as "AEO" for marketing purposes.

In the same sense, AEO must meet specific obligations to maintain its qualification: compliance of conditions and criteria evidenced for the application, to appoint a permanent contact, to permit inspections, control and assurance of the logistics chain, to use the distinctive mark, to reply promptly to all requirements of the Customs Authority.

AEO can be suspended for 60 days if the operator does not permit inspections or unduly uses its qualification and mark, to not amend given observations from the authority or to have been cancelled as an economic operator (importer, exporter, courier, etc., accordingly).

AEO can also be cancelled and the Customs Authority will revoke the qualification if the operator has been suspended twice, to be in bankruptcy, to have a judicial judgment against it for economic

and/or customs crimes, to have simulated any factor to be qualified as AEO or to have been canceled as economic operator. If any of the last three conditions occur, the applicant cannot request for a new process and cannot be considered as AEO.

Finally, Mutual Recognition Agreements between the Ecuadorian Customs Authority and other countries will be promoted to benefit AEOs by granting the same benefits in other jurisdictions. ■

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Latest developments on the US-China trade dispute

The ongoing trade dispute between the United States (US) and China has continued through recent months.

Negotiations between the world's two largest economies continue; the next meetings of ministerial-level negotiators are now set for October in Washington, DC. But with no resolution reached, both sides have continued to raise the stakes by subjecting more products to duties and increasing rates.

As discussed in the last EY *TradeWatch* issue (Summer 2019), since taking office, President Donald Trump's trade agenda has had an extensive focus on addressing what the administration has determined to be unfair trade practices by US trading partners, with increased scrutiny on China in particular.

Beginning in August 2017, following the directive in a Presidential Memorandum,[1] the United States Trade Representative (USTR) launched an investigation into China's trade policies under Section 301 of the Trade Act of 1974.[2] The investigation was intended to determine whether Chinese laws and trade policies had a material and damaging impact on US companies, and, if so, what actions the US should take in response.

The USTR's investigation concluded that China's trade and intellectual property (IP) practices were harmful to US companies and, ultimately, the US economy.[3] Subsequently, the USTR imposed a series of punitive tariffs on approximately US$250b[4] worth of Chinese origin goods, known as Lists 1,[5] 2[6] and 3.[7] Each of the three lists currently carry a 25% punitive tariff and as further detailed below, are scheduled to increase to 30% on 1 October.

1 https://www.whitehouse.gov/presidential-actions/presidential-memorandum-united-states-trade-representative/
2 https://ustr.gov/sites/default/files/enforcement/301Investigations/FRN%20China301.pdf
3 https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF
4 Currency references in this article are to US$.
5 https://ustr.gov/sites/default/files/2018-13248.pdf
6 https://ustr.gov/sites/default/files/enforcement/301Investigations/2018-17709.pdf
7 https://ustr.gov/sites/default/files/enforcement/301Investigations/Tariff%20List%20%2883%20FR%2047974%2C%20as%20amended%20and%20modified%20by%2083%20FR%2049153%29.pdf

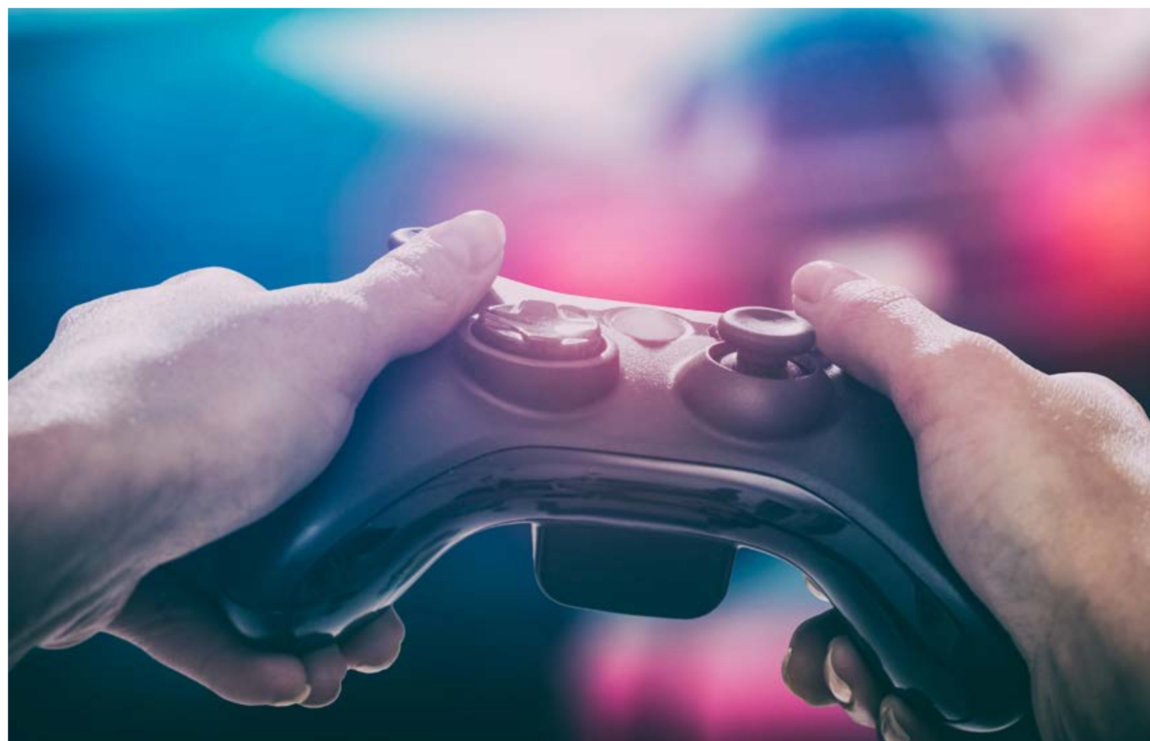
In response to the slow pace of negotiations and lack of progress, the USTR released a proposed product list (List 4) covering US$300b in Chinese-origin imports and comprising 3,805 tariff codes intended to be subject to up to 25% punitive duties in a 13 May 2019 Federal Register Notice (FRN).[8] In the FRN, the USTR asked for public commentary and subsequently held hearings for companies to express concerns and adverse impacts that may result from the tariffs.

Following a round of negotiations in Shanghai that ended with the two countries still far from agreement, President Trump announced via Twitter on 1 August 2019 that the US would move forward with an imposition of 10% punitive tariffs, rather than the originally proposed 25%, on the previously announced List 4.[9] Shortly thereafter, to formalize the list of subject products and following significant concerns to the proposed tariffs by many industry associations and impacted importers, the USTR then published List 4A and List 4B, with the punitive tariffs to be implemented on 1 September 2019 and 15 December 2019, respectively.[10]

With many of the consumer products such as video games and cell phones appearing on List 4B, the USTR seemingly took public commentary into consideration to minimize potential impact to consumers prior to the upcoming holiday season. It was noted by the USTR in the FRN that the methodology used in determining whether tariff codes were placed on list 4A or list 4B was based upon the percentage of goods imported that were of Chinese origin, taken from 2018 import data. The USTR stated that if the product was determined to be 75% or more of Chinese origin, it was placed on List 4B for 15 December 2019 implementation. However, if the product was less than 75% of Chinese origin of the time, it was slated for 1 September 2019 implementation on List 4A.

Notable product categories by list

List 4A	List 4B
Apparel provided for in CH 61	Certain outerwear, such as scarves and mittens in CH 61
Footwear provided for in CH 64	Mobile phones provided for in CH 85 and laptops provided for in CH 84
Glasses and contacts provided for in CH 90	Headphones provided for in CH 85
Cameras provided for in CH 90	Video game consoles provided for in CH 95
Musical instruments provided for in CH 92	Toys provided for in CH 95
Sports equipment provided for in CH 95	Holiday décor provided for in CH 95



8 https://ustr.gov/sites/default/files/enforcement/301Investigations/84_FR_22564.pdf

9 https://www.reuters.com/article/us-usa-trade-tariffs-factbox/tariff-wars-duties-imposed-by-trump-and-u-s-trading-partners-idUSKCN1UR5YD

10 https://ustr.gov/sites/default/files/enforcement/301Investigations/Notice_of_Modification_%28List_4A_and_List_4B%29.pdf

On 23 August 2019, in response to US action on List 4A and List 4B, China's Customs Tariff Commission (Commission) reacted with a new round of their own punitive tariffs at 5% and 10% on US-origin goods. The tariffs, which will cover 5,078 line items amounting to US$75b (China List 4[11]), will follow the US model for List 4; two lists to be executed the same days as the US tariffs, 1 September 2019 and 15 December 2019. In addition to the imposition of new punitive tariffs, the Commission also announced that they would resume tariffs on US-origin vehicles and parts beginning on 15 December 2019.

In addition to imposing the new reactive tariffs of China List 4, on 2 September 2019, China filed a complaint with the World Trade Organization (WTO) against the US regarding the increasing tariff rates on Chinese origin goods, as outlined under the docket that cited a violation under the General Agreement on Tariffs and Trade (GATT) as the basis of China's complaint.[12] This is the third such complaint lodged by Beijing since the US administration began imposing punitive tariffs on Chinese goods. The US has not yet responded formally to the latest complaint, but on 30 August 2019, the USTR published a written response to the first WTO complaint filed by China. In their statement to the WTO, the US noted that the two nations had previously reached a consensus that their dispute should not be brought to arbitration at the WTO level, and continued to stress that the actions taken against China were in direct response to China's unchanged policies regarding IP.

The US immediately responded to the 23 August actions taken by China with the USTR announcing a 5% increase to the existing 25% tariffs on US$250b of Chinese origin goods on Lists 1, 2 and 3, beginning 1 October 2019.[13] The originally declared 10% punitive tariff on the US$300b of Chinese origin goods of Lists 4A and 4B would be raised to 15%, to take effect on their previously announced dates. In their press release, the USTR directly correlated their actions to China's "unjustified tariffs targeting US products."

Implementation date	Tariff action	List(s) impacted
1 September 2019	15%	List 4A
1 October 2019	5% (in addition to already in place 25%)	Lists 1, 2 and 3
15 December 2019	15%	List 4B

In addition to the formal response of increased punitive tariffs on all four lists, President Trump publicly addressed China's actions via Twitter. In a tweet on 23 August 2019, President Trump announced that he was "hereby ordering" US companies to immediately begin searching for alternatives to China, including bringing manufacturing back to the US. In the same announcement, President Trump also ordered carriers such as Fed Ex, Amazon, UPS and the US Postal Service to begin searching for, and subsequently refusing, all shipments of Fentanyl from all countries, though specifically from China. There has been no official proclamation from the White House or other government agencies enforcing either of President Trump's statements to date.

As with the previous three lists, the USTR has stated that companies will be able to apply for exclusions for products on List 4A and List 4B, though at time of publication, the process has not been formally announced. The exclusion process for both lists is expected to be similar to that for List 3, which allows for submissions via a web-based portal.

As of 6 September, the USTR has published that it has denied 6,879 or 63.55% of the 10,825 exclusion requests for List 1 and 1,484 or 50.70% of the 2,927 exclusion requests for List 2. The deadline for submitting exclusion requests for List 3 is 30 September 2019, however, the USTR has already begun to publish denials and granted exclusions for requests received to date. Of the 13,037 exclusion requests submitted, the USTR has denied 94 or .72%, and granted 15 or .12%. The 15 List 3 exclusions granted include:

- Container units of plastics configured or fitted for the conveyance, packing or dispensing of wet wipes imported under 3923.10.9000
- Certain injection molded polypropylene plastic caps or lids used for dispensing wet wipes imported under 3923.50.0000
- Certain double-ended kayak paddles imported under 3926.90.3000

11 Announcement of the Customs Tariff Commission of the State Council with regard to Increasing Additional Tariffs on Certain Imported Goods Originating from the United States. http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201905/t20190513_3256788.html

12 https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=256626&CurrentCatalogueIdIndex=0&FullTextHash=&HasEnglishRecord=Tr ue&HasFrenchRecord=True&HasSpanishRecord=True

13 https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/august/ustr-statement-section-301-tariff

- High tenacity polyester yarn not over 600 decitex imported under 5402.20.3010
- Certain nonwovens imported under 5603.92.0090
- Pet cages of steel imported under 7323.99.9080
- Shopping carts imported under 8716.80.5090
- Truck trailer skirt brackets imported under 8716.90.5060
- Certain inflatable boats, other than kayaks and canoes, imported under 8903.10.0060
- Certain inflatable kayaks and canoes imported under 8903.10.0060

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Actions for businesses

With the implementation of List 4A and pending List 4B, nearly all products from China are subject to punitive duties upon import into the US. Combined with the continued and increasing tariffs on US products imported into China, any company involved in US-China trade should continue to identify the potential impact of additional duties and explore mitigation strategies.

Continued close monitoring of the negotiations and any political developments is warranted, as companies will want to assess any liability under a changing tariff regime. Terms of any deal reached are likely to contain specific conditions that may impact certainty, and possibly duration, of outcomes and will need to be closely analyzed once made available. Further escalation of tensions may also warrant actions by companies now to have alternative operational plans to adjust as necessary in mitigating business disruption and costs from the ongoing dispute.

Immediate actions for such companies to consider include:

- Evaluating Lists 4A and 4B to identify specific products and the respective impacts of the announced tariff rates going into effect (including a review of tariff classification determinations and considerations for supply chain or manufacturing adjustments to help mitigate potential tariffs) include the incremental increases announced. Importantly, with the recent escalations on both sides, companies may need to revisit previously conducted impact analyses.
- Reviewing contracts with suppliers and with customers to understand who has liability for increased duties and if there are opportunities for negotiation.
- Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted; potential costs; alternative sourcing options; alternative manufacturing options, including relocation of production outside of China; and to assess any opportunities to mitigate impact, such as country-of-origin planning, to address potential increases in 301 tariffs.
- Identifying strategies to defer, eliminate or recover the excess duties paid under Section 301, such as bonded warehouses, Foreign Trade Zones, substitution drawback, Chapter 98 and equivalent programs under China customs regulations.
- Exploring strategies to minimize the customs value of imported products subject to the additional duties under either 301 tariffs, re-evaluating current transfer pricing approaches, and for US imports, considering US customs strategies, such as First Sale for Export.

Companies importing goods from China that are included on List 4 should closely monitor and participate in any exclusion process the USTR may issue. Companies also should actively develop procedures to support necessary documentation for imported goods that will be subject to List 4, as similar to the past actions, where subject goods that ultimately receive exclusion status after the tariff imposition date are expected to be eligible for a refund on punitive duties paid through the Customs Post Summary Correction procedures.

Managing ongoing trade costs: Is business certainty attainable in the current legal landscape of US country of origin determinations?

With the extended duration of the US-China trade dispute, many companies have shifted focus toward diversifying supply chains and moving certain production out of China. Some of these moves may have already been in motion, and perhaps expedited due to the ongoing, and deepening, trade dispute. Others may be a direct result of the tariffs, which are likely viewed as so impactful as to independently justify supply chain adjustments. The additional tariffs imposed against certain Chinese-origin goods under Section 301 of the Trade Act of 1974 (Section 301 tariffs) are currently applied at 15%–25% ad valorem rates, with more than half by dollar volume currently set to increase to 30% on 15 October 2019.[1]

Before making any adjustments to supply chains, importers should understand that these Section 301 tariffs apply based on the country of origin of the goods, rather than simply the country of export. While the legal framework for determining proper country of origin under US Customs rules has been consistently based on the "substantial transformation" analysis, focusing on change in name, character and use, the analysis provides for a flexible determination based on the totality of circumstances and may incorporate a variety of nonexclusive factors. Determinations are heavily product-specific and process-specific.

1 While the US Trade Representative (USTR) had requested comments on the proposed rate increase from 25% to 30% for certain tariffs with an effective date of 1 October 2019 (see 84 FR 46212), President Trump subsequently indicated the tariff increase would be delayed to 15 October 2019. For additional details on the Section 301 tariffs, please see the article titled *Latest developments on the US-China trade dispute* on page 13 in this issue of *TradeWatch*.

Given the volume and complexity of recent origin rulings, both favorable and unfavorable, importers should consider the need for certainty of any origin determinations. This is to help inform business risk and help guide business decisions where consideration is being given to shifting certain or all components in a supply chain with China origin, or shifting of manufacturing to countries outside of China. The impact of an incorrect origin analysis could be quite substantial, as the tariffs may be imposed retroactively where customs ultimately disagrees. The US entry process and duration of post-importation review of declared information, including origin, may result in a significant value of imports being subject to rate advance changes, and possibly penalties. To validate the favorability of any planned changes, as well as to meet the reasonable care standard imposed on US importers, a thorough review and documentation of US Customs rules for determining country of origin is often warranted.

High visibility of changes to supply chains

US Customs and Border Protection (CBP) has high visibility to any changes to transactional import data (through the Automated Commercial Environment (ACE) portal), and is able to identify and possibly target historically Chinese-origin imports that underwent a recent adjustment to origin, thereby avoiding the application of Section 301 tariffs. CBP may conduct post-entry reviews to identify such transactions and request additional support either through a CBP Form 28, Request for Information, or during a customs audit. The post-importation time frame is typically 314 days, however CBP may suspend "liquidation" should an issue or potential

violation be under consideration, thereby extending an importer's exposure to a year's worth of imports, or longer, until resolved. Post-liquidation, CBP may review importations under penalty provisions for up to five years after import in the case of negligence or gross negligence violations, or up to five years after the date of discovery in the case of fraud. See 19 U.S.C. 1592; 19 U.S.C. 1621.[2]

Recent fact patterns considered

CBP rulings commonly address the scenario where raw materials, solely or heavily sourced from China, are shipped to a third country for further processing into a finished good before import into the US.

The analysis typically turns on whether the third country processing rises to the level of a substantial transformation, thereby conferring third-country origin to the finished good. Where no substantial transformation is identified in the supply chain, and raw material components are sourced from multiple countries, CBP must nonetheless determine the proper origin for the finished good, which may be quite difficult depending on the facts.

Recent rulings have also dealt with nontraditional fact patterns where non-Chinese-origin raw material components are imported into China for assembly, and the importer argues that the assembly processes in China do not constitute a substantial transformation. In these cases, CBP must consider whether the assembly in China is sufficient to confer Chinese-origin status to the finished good.

Substantial transformation analysis

CBP has determined the substantial transformation analysis, which is generally used for non-preferential country-of-origin determinations, should be used for determining applicability of Section 301 duties.[3] Goods that are not wholly produced in a single country, should be considered a product of the last country where it has been "substantially transformed into a new and different article of commerce with a name, character or use distinct from that of the article or articles from which it was so transformed."[4]

2 In the case of customs penalty violations, the importer may be liable for any duties and fees owed, as well as interest and possible penalty amounts.

3 See e.g., HQ H303140 (April 19, 2019).

4 19 U.S.C. § 2518.

In *Energizer Battery, Inc. v. US*,[5] the Court of International Trade interpreted the meaning of the term "substantial transformation" when considering the determination of the country of origin of a flash light. Relying in part on the simple nature of the assembly and predetermined names and end-use of the components, the Court determined the individual parts of the flash light did not lose their separate identities and become integral parts of a new article.

The *Energizer* Court reasoned that the components of the flash light did not lose their individual names as a result the assembly (e.g., a lug was called a "G-head" at import and after assembly) and clarified that the analysis should not consider whether the components as imported have the form and function of the final product, but rather whether the components have a predetermined end-use at the time of importation. For example, the Court noted that even the imported wire was pre-cut to the lengths needed to assemble the flash light. The *Energizer* Court also cited the simplistic nature of the assembly process, illustrated by the language used to describe it, the length of time required and the proportion of components that can be categorized as attaching mechanisms. Recent rulings have generally leaned on *Energizer* to guide the analysis and generally make a point to distinguish facts from *Energizer* where the analysis substantially differs. Nevertheless, importers should take a holistic approach to origin determinations, understanding that the determination is not limited by the analysis conducted in any one ruling or case, and ultimately turns on whether, **based on the totality of circumstances**, the raw material components **undergo a change in name, character and use**.

Such a determination may vary based on the specific product and particular processing activities at issue. Past rulings that deal with substantially similar goods and components, as well as similar processing activities, may provide helpful insight as to the proper analysis, though importers should take note of any distinctions in prior rulings and adjust the analysis accordingly.

How to manage the risk: is business certainty attainable?

Recent Section 301 tariffs have resulted in heightened uncertainty and risk. CBP has the ability to identify high-risk entries and ultimately impose the tariffs retroactively where the agency disagrees with origins declared at the time of import. Penalties may also be imposed where reasonable care is lacking.

Companies with US imports that incorporate Chinese-origin components and/or processing activities conducted in China should consider whether sufficient business certainty and risk management is achieved through origin determinations based on available guidance and/or third-party advice, or whether, in light of the potential costs and complex legal landscape, a formal ruling request is warranted.

Success in confirming and/or defending origin positions is more likely where importers can clearly lay out the relevant facts, summarize the legal precedent and apply the legal framework to the relevant facts in support of the proposed origin. Where factual distinctions exist, importers should be prepared to support how the analysis may or may not change as a result of such distinctions.

Whether for the purposes of ruling request submissions or to document support in case of customs inquiry, origin determinations should be comprehensive, sufficiently documented, and with regards to substantial transformation analyses, focused on the overarching goal: clearly illustrate a change in name, character and use under the relevant facts and pursuant to US Customs rules. ■

5 Energizer Battery, Inc. v. US, 190 F.Supp.3d 1308 (2016).

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Spotlight on latest developments in Canadian trade

Canada amends the Schedule to the Customs Tariff to correct technical errors affecting tariff items under the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) preferential tariff

Background

On 7 August 2019, the Government of Canada amended the *Schedule to the Customs Tariff* (the Schedule) to correct errors in the implementation of the CPTPP. Due to an error with the transposition of Canada's tariff commitments under the CPTPP, 15 tariff items in the Schedule were assigned the incorrect staging category for the CPTPP preferential tariffs in domestic legislation. As a result, upon entry into force of the CPTPP, 14 of those tariff items were incorrectly granted duty-free status and one tariff item was made subject to a gradual phase-out of customs duties when it should have been duty-free upon entry into force of the CPTPP.[1]

The goods affected by the error are hybrid-power train and solely-battery-electric power train passenger auto mobiles, buses, certain textile floor coverings and miscellaneous rubber tires. To correct the error in transposing the CPTPP tariff commitments, the Government of Canada amended the Schedule by making the *Order Amending the Schedule to the Customs Tariff (CPTPP)* (the Order). The Order, which came into force on 8 August 2019, amends the staging categories for CPTPP preferential tariffs for the affected tariff items to properly reflect Canada's tariff commitments under the CPTPP. The revised tariff will only apply after the date of entry into force of the Order. Any affected goods that were in transit to Canada as of the date the Order came into effect will still benefit from duty-free treatment upon importation into Canada.[2]

Impact

As a result of the Order, the affected tariff items will see an increase in their respective duty rates. Affected importers are advised to review their import data to analyze the impact these changes will have on the cost of importing these goods into Canada.

In addition, the CPTPP Remission Order entered into force on 8 August 2019. The remission order remits customs duties paid on importations, made under

1 Explanatory Note to SOR/2019-292.
2 SOR/2019-292.

CPTPP preferential tariff treatment, of miscellaneous rubber tires between 30 December 2018 and the date of entry into force of the remission order, as these goods were incorrectly subject to a 3% duty rate. Importers may file a claim for remission within two years after the date of importation of the goods.[3]

Canada-Israel Free Trade Agreement modernization to take effect 1 September 2019

On 1 September 2019, the *Act to amend the Canada-Israel Free Trade Agreement Implementation Act and make related amendments to other Acts* (the Act) entered into force.[4] The Act allows for the implementation of the May 2018 Canada–Israel Free Trade Amending Protocol 2018, which provides for updates to provisions of existing chapters in the CIFTA, and for the addition of several chapters to the trade agreement.

Background

Upon entry into force of the modernized CIFTA, almost all Canadian exports of agricultural, agri-food, fish and seafood will benefit from preferential tariff treatment in Israel. This is an increase from 90% of these types of goods benefiting from preferential tariff treatment under the non-modernized CIFTA.

Canada will provide incremental duty-free access for Israeli agriculture and agri-food imports; however, Canadian over-quota tariffs on supply management goods (dairy, poultry and eggs) will remain and are excluded from any tariff reduction, quota expansion or creation.[5] New provisions will also be added to address non-tariff barriers and to establish mechanisms under which Canada and Israel can cooperate to discuss and resolve issues related to non-tariff barriers.[6]

Rules of origin under the modernized CIFTA have been simplified and liberalized. The modernized *CIFTA Tariff Preference Regulations* (the modernized *Regulations*) will now allow goods eligible for CIFTA preferential tariff treatment that are shipped indirectly between Israel and Canada to retain eligibility, provided the goods remain under customs control. The modernized *Regulations* also expand the list of eligible "non-party" countries wherein minor processing of certain CIFTA-eligible goods,[7] or processing that does not increase the transaction value of certain CIFTA-eligible goods by more than 10%, will not disqualify those goods from being originating under CIFTA.[8] Under the pre-modernization tariff preference regulations, the US was the sole eligible non-party country. Under the modernized *Regulations*, the Member States of the European Free Trade Association (EFTA), the Member States of the European Union (EU), Jordan and Mexico are now eligible non-party countries.[9]

Impact

With the modernization of the CIFTA, Canadian importers will benefit by seeing a reduction in customs duties payable on CIFTA-originating imports. Likewise, the removal of tariffs on Canadian exports will make those goods more competitive in the Israeli market. As the global market continues to face challenges and uncertainties over the imposition of tariffs and their duration, the further liberalization of Canadian–Israeli trade should be welcome news to Canadian importers and exporters.

3 SOR/2019-293.
4 SI/2019-77.
5 Explanatory Note to SI/2019-77.
6 Explanatory Note to SI/2019-77.
7 Goods listed in any of Chapters 50 through 63 of the List of Tariff Provisions are excluded, as they are subject to other rules of origin within the CIFTA.
8 SOR/2019-278.
9 SOR/2019-278.

Canada repeals *Canada-Costa Rica Free Trade Agreement Non-entitlement to Preference Regulations*

Effective 8 August 2019, Canada is extending entitlement of the Canada–Costa Rica Free Trade Agreement (CCRFTA) preferential tariff treatment to certain goods that originate under the CCRFTA but were previously excluded from preferential tariff treatment.[10]

Background

The CCRFTA entered into force on 1 November 2002. Under the CCRFTA *Non-entitlement to Preference Regulations* ("the Regulations"), enacted on 31 October 2002 pursuant to Canada's Customs Tariff, certain goods that undergo operations in a Costa Rica Free Trade Zone (FTZ) are deemed not to originate in Costa Rica and are not entitled to preferential tariff treatment under the Costa Rica Tariff rate.[11] This restriction stems from the nature of the tariff elimination obligations agreed to under the CCRFTA. Canada's obligation to eliminate tariffs on certain goods was contingent on Costa Rica removing all business tax exemptions and other export subsidies for goods produced wholly or partially in Costa Rican FTZs.[12]

Impact

As the Government of Canada is now satisfied that Costa Rica has eliminated business tax exemptions and other export subsidies, the *Regulations* have been repealed, and originating goods previously exempt can now benefit from preferential tariff treatment. These goods were listed in categories A1, B, C and D of Canada's tariff elimination schedule under the CCRFTA, and include apparel, textiles and tire products. These goods can now be imported duty free into Canada. The Government of Canada expects to forego approximately CAD2.7 million in customs duties due to the repeal of the *Regulations*.[13]

As the affected goods were originally subject to moderate or high duty rates, Canadian importers sourcing the affected goods will see a notable reduction in customs duty costs for these goods.

Government of Canada to remit surtaxes collected on certain imports of heavy steel plate and stainless steel wire

Effective 23 August 2019, the Surtax on the Importation of Certain Steel Goods Remission Order (*Surtax Remission Order*) entered into force, relieving surtax paid since October 2018 on seven types of imported heavy steel plate and one type of imported stainless steel wire that were subject to provisional safeguard surtaxes in Canada.[14]

Background

The provisional surtaxes are applied to several steel goods originating from all countries except for those originating in Canada, Chile, Columbia, Mexico, Panama, Peru, the Republic of Korea, the US, Israel or another CIFTA beneficiary, and World Trade Organization (WTO) Member countries that are a beneficiary of the General Preferential Tariff (GPT).[15] Pursuant to an inquiry conducted by the Canadian International Trade Tribunal (CITT) to determine whether final safeguards should be applied to the affected goods, effective 13 May 2019, the range of goods subject to final safeguard measures were limited to two types of steel goods: heavy steel plate and stainless steel wire.[16] These final safeguards replace the provisional safeguards that were previously in effect.

On 9 May 2019, the CITT was directed under the terms of the *Exclusions Inquiry Order* to conduct an inquiry regarding exclusion requests for certain heavy steel plate and stainless steel wire goods that were subject to safeguard measures since 30 October 2018.[17] On 15 July 2019, the CITT recommended that exclusions be granted for seven types of heavy steel plate and one type of stainless steel wire.[18,19] As a result, effective 23 August 2019 importers of the excluded items may be eligible for a refund of surtaxes paid on excluded goods released by the Canada Border Services Agency (CBSA) since October 25, 2018.[20]

Impact

Remission will be granted to qualifying importers of the excluded goods if:

10 SOR/2019-290.

11 SOR/2002-398.

12 Explanatory Note to SOR/2019-290.

13 Explanatory Note to SOR/2019-290

14 SOR/2019-315.

15 Subject goods from GPT beneficiary countries were exempt from surtax if the share of imports from such a country does not exceed 3% of total imports of each good, provided that imports from countries accounting for less than 3% of import share do not collectively account for more than 9% of total imports of each good.

16 Canadian International Trade Tribunal — Safeguard Inquiry into the Importation of Certain Steel Goods, Inquiry No. GC-2018-001.

17 GC-2018-001-E1.

18 GC-2018-001-E1.

19 For a complete listing of the exclusions, see Table 1 in Customs Notice 19-08, Final Safeguard Measures Imposed on the Importation of Certain Steel Goods.

20 SOR/2019-313.

- No other claim for relief of the surtax, or the portion of the surtax, as applicable, has been granted under the *Customs Tariff* in respect of those goods

And

- A claim for remission is made by the importer to the Minister of Public Safety and Emergency Preparedness within two years after the date of the importation of those goods.[21]

Importers of the subject goods must file a Form B2, Canada Customs–Adjustment Request with the CBSA Trade Programs Office under section 74(1)(g) of the *Customs Act*. In addition, importers will need to provide product literature, technical specifications, and any other relevant documentation that substantiates whether the goods correspond to the exclusions eligible for remission.[22] As CBSA will likely process remission applications on a first-come, first-serve basis, importers must ensure that their submissions are complete and accurate to avoid delays or even refusal of their request for surtax remission.

Government of Canada enhances trade remedy system by amending the Special Import Measures Regulations (SIMR)

The Government of Canada has amended the SIMR to provide the CBSA with additional methods for calculating appropriate dumping margins in its anti-dumping investigations. The amendments are expected to provide the CBSA with more flexibility in determining production costs in transactions between associated parties and market situations.

Background

Under the Special Import Measures Act (SIMA), Canadian domestic producers may request to have anti-dumping and countervailing duties imposed on imports following investigations by the CBSA to determine whether imports were dumped or subsidized, and the CITT to determine whether imports injure or threaten to injure Canadian producers.[23]

Due to continuing challenges in the global steel trade environment and persistent overcapacity in global steel production, Canadian steel producers have raised concerns that Canada's trade remedy system requires additional mechanisms to better address cases of dumped and unfairly subsidized goods being imported into the Canadian market and causing injury to Canadian producers.[24] Following consultations with industry stakeholders in spring 2019, the Government of Canada adopted recommendations received during those consultations by amending the SIMR to clarify certain elements related to the calculation of the costs of production in anti-dumping investigations.[25]

Amendments to the SIMR

Transactions between associated parties

The amendments made to the SIMR address the calculation of production costs in transactions between associated parties (such as a subsidiary or affiliated entity). In cases where an input used in the production of goods is acquired by the exporter or producer from an associated person and is a significant factor in the production of the goods, the cost of the input in the export will be considered by CBSA to be the greater of the following amounts:

- The price paid in respect of the input by the exporter or producer to the associated person

21 Customs Notice 19-08, Final Safeguard Measures Imposed on the Importation of Certain Steel Goods.

22 Customs Notice 19-08, Final Safeguard Measures Imposed on the Importation of Certain Steel Goods.

23 Regulatory Impact Analysis Statement to SOR/2019-314.

24 Regulatory Impact Analysis Statement to SOR/2019-314.

25 Regulatory Impact Analysis Statement to SOR/2019-314.

- The cost incurred by the associated person in the production of the input, including the administrative, selling and all other costs with respect to the input
- The price in the country of export of the same or substantially the same inputs, if enough information is available to enable the price to be determined based on:
  - The selling prices of those inputs in the country of export, in the same or substantially the same quantities, between parties who are not associated persons

Or

  - The published prices of those inputs in the country of export[26]

Particular market situation

Prior to the amendment of the SIMR, CBSA could, when determining production costs in an anti-dumping investigating, disregard sales in the domestic market of the exporting country if the sales are affected by a particular market situation. In such cases, the CBSA can use alternative methodologies when calculating dumping margins.[27] The amendments to the SIMR provide alternative options to determine the cost of inputs of goods imported into Canada when a particular market situation does not permit a proper comparison to be made between the sale of goods in the country of export and the sale of goods exported to Canada.[28] According to the amendments, the cost of input in the country of export shall be considered to be the *first* of the following amounts that reasonably reflects the actual cost of the input so as to permit a proper comparison:

- The price of the same or substantially the same inputs that are produced in the country of export and sold to the exporter or to other producers in the country of export
- The price of the same or substantially the same inputs that are produced in the country of export and sold from the country of export to a third country
- The price of the same or substantially the same inputs determined by the published prices of those inputs in the country of export
- The price of the same or substantially the same inputs that are produced in a third country and sold to the exporter or to other producers in the country of export, adjusted to reflect the differences relating to the price comparability between the third country and the country of export

Or

- The price of the same or substantially the same inputs determined by the published prices outside the country of export, adjusted to reflect the differences relating to price comparability with the country of export[29]

The Canadian Government expects the amendments to SIMR will provide Canadian producers with access to mechanisms like those available to the producers of trading partners such as Australia, the European Union and the US. The amendments to SIMR are expected to ensure that appropriate margins of dumping can be calculated by allowing CBSA to take account of potential distortions, due to transactions between associated parties and the effects of particular market situations when determining the costs of production in its anti-dumping investigations.

This will ensure that Canada's trade remedy system can offer comparable levels of protection for domestic producers from the effects of unfair trade and maintain a fair and balanced approach to trade remedies in line with Canada's legal and trade obligations.[30]

Canada amends the Import Control List, creates new permit requirements to meet commitments in monitoring the aluminum and steel trade

In conjunction with the amendments to the SIMR, the Government of Canada has implemented new reporting requirements for imports of carbon steel, specialty steel products and aluminum products, in a bid to improve Canada's steel and aluminum import regime and meet its commitments under the *Joint Statement by Canada and the United States on Section 232 Duties on Steel and Aluminum* (Joint Statement).

26 SOR/2019-314, s. 5.
27 Regulatory Impact Analysis Statement to SOR/2019-314.
28 Regulatory Impact Analysis Statement to SOR/2019-314.
29 SOR/2019-314, s. 5.
30 Regulatory Impact Analysis Statement to SOR/2019-314.

Background

On 1 June 2019, the US announced the application of Section 232 tariffs on imports of Canadian-origin steel and aluminum products. In response, the Government of Canada imposed countermeasures on 1 July 2018 and initiated dispute settlement proceedings at the World Trade Organization (WTO) and under the North American Free Trade Agreement (NAFTA) dispute settlement provisions. On 17 May 2019, both the US section 232 tariffs and the Canadian countermeasures were removed as agreed to in the *Joint Statement by Canada and the United States on Section 232 Duties on Steel and Aluminum* (the Joint Statement). As part of the agreement, Canada and the US agreed to establish a monitoring process for the aluminum and steel trade.[31]

Impact

As Canada does not currently monitor imports of aluminum, effective 1 September the *Import Control List* has been amended to add alloyed and not alloyed unwrought aluminum products, and wrought aluminum products limited to bars, rods, profiles, wires, plates, sheets, strips, foils, tubes and pipes, tube and pipe fittings, and other articles of castings and forgings to the list of articles controlled for monitoring purposes.[32] *General Import Permit No. 83–Aluminum Products* (GIP 83)[33] will now be required to import the aluminum goods added to the *Import Control List*. GIP 83 also includes a reporting requirement; Global Affairs Canada (GAC) may send a request to the importer to provide records and documents relating to the country of origin, price or quantity of the imported aluminum in respect of any import effected during the specified period in the request. The importer must provide the requested documentation within 10 days after receipt of a request from GAC. The import documentation for each shipment of aluminum products must indicate a reference to GIP No. 83.[34]

Although Canada already monitors imports of carbon steel and specialty steel products, importers of these goods were not subject to reporting requirements. Following recommendations from consultations with industry stakeholders and to implement Canada's commitments under the Joint Statement, effective 26 August 2019 *General Import Permit No. 80–Carbon Steel and General Import Permit No. 81–Speciality Steel Products* have been amended to add a reporting and record keeping requirement for goods imported under these permits.[35]

Carbon steel products include semi-finished products (ingots, blooms, billets, slabs and sheet bars), plate, sheets and strip, wire rods, wire and wire products, railway-type products, bars, structural shapes and units, pipes and tubes made of carbon steel. These items are covered by Harmonized System (HS) headings 7206-7229 of the *Customs Tariff*.

Specialty steel products include stainless steel flat-rolled products (sheet, strip and plate), stainless steel bar, stainless steel pipe and tube, stainless steel wire and wire products, alloy tool steel, mold steel and high-speed steel. These items are covered by HS headings 7301-7302, 7304-7306, 7308, 7312-7313 and 7317 of the *Customs Tariff*.

Akin to the reporting requirements for aluminum products, upon request from GAC importers must provide, within 10 days from the request, records and documents relating to the country of origin, price or quantity of the imported carbon steel or specialty steel products in respect of any import effected during the specified period in the request. The import documentation for each shipment of carbon steel or specialty steel products must indicate the appropriate GIP permit.[36]

For GIPs 80, 81 and 83, importers must maintain documents and records for a period of six years after the year in which the respective import was made.[37] Both the steel and aluminum import monitoring programs do not limit the quantity of products that can be imported into Canada.[38] ■

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31 Regulatory Impact Analysis Statement to SOR/2019-316.

32 SOR/2019-316, s.1.

33 The Commodity Codes Handbook contains the specific Harmonized System codes of the goods covered by GIP 83.

34 Notice to Importers-General Import Permit No. 83-Aluminum Products; SOR/2019-319

35 SOR 2019-318.

36 Notice to Importers-Steel General Import Permits No. 80 and 81–Carbon and Specialty Steel Products.

37 SOR/2019-317; SOR/2019-318; SOR/2019-319.

38 Notice to Importers-General Import Permit No. 83-Aluminum Products; SOR/2019-319; Notice to Importers-Steel General Import Permits No. 80 and 81-Carbon and Specialty Steel Products.

US export controls on "emerging technologies"

Executive summary

US "dual use" export controls are administered by the United States Department of Commerce Bureau of Industry and Security (BIS) and restrict the export or release of certain sensitive or critical technologies. With the rapid development of technologies, such as quantum computing and artificial intelligence, both BIS and its foreign counterparts have struggled to keep up with regulating the export of what is known as "emerging technology."

Background

In 2018, the US Congress passed the Export Control Reform Act of 2018 (ECRA) which, in addition to formalizing the export control implementation authority of BIS, also authorized the establishment of interim controls for "emerging and foundational technologies" that are "essential to the national security of the United States." Additionally, Congress passed the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), which significantly increased Congressional authority to conduct "national security reviews" on foreign investments that could result in foreign control over critical US technology.[1]

Following passage of the ECRA and FIRRMA, BIS issued a request for public comments to assist with the identification of these emerging and foundational technologies through 19 December 2018.[2] BIS asked industry to comment on: 1) how to define emerging technology to assist identification of such technology in the future; 2) criteria to apply to determine whether there are specific technologies within these general categories that are important to US national security; 3) sources to identify such technologies; 4) other general technology categories that warrant review to identify emerging technologies that are important to US national security; 5) the status of development of these technologies in the US and other countries; 6) the impact specific emerging technology controls would have on US technological leadership; and 7) any other approaches to the issue of identifying emerging technologies important to US national security, including the stage of development or maturity level of an emerging technology that would warrant consideration for export control.[3]

Additionally, following the Wassenaar Arrangement plenary meeting on 5–6 December 2018, the Member States agreed to work together to adopt "new export controls in a number of

1 The Committee on Foreign Investment in the United States (CFIUS) is a US Government inter agency committee authorized to review certain transactions involving foreign investment in the US to determine the effect such transactions have on national security. See https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius.

2 83 FR 58201-02.

3 Id. The request for comment included a representative list of technology, such as position, navigation and timing (PNT) technology, quantum computing, quantum encryption and robotics.

areas" with a particular focus on the emerging technologies.[4] On 23 May 2019, BIS amended the Export Administration Regulations (EAR) to add new and revised export controls on certain categories of technology in conformity with the Wassenaar Arrangement agreement as described below. It should be noted that BIS has *not yet* issued US-specific (unilateral) controls on these technologies, which will involve US Government interagency review.

Additional export controls impacting high-tech industries — Wassenaar Arrangement multilateral controls

Effective 23 May 2019,[5] BIS added new controls to the Commerce Control List (CCL) on emerging technologies in Category 3, Category 5 (Part II), Category 6 and Category 9, more specifically on technologies related to:

1. Discrete microwave transistors (a major component of wideband semiconductors) rated for operation with a peak saturated power output greater than 5 W (37.0 dBm) at all frequencies exceeding 8.5 GHz up to and including 31.8 GHz (ECCN 3A001.b.3.f)
2. Software specially designed to restore normal operation of a microcomputer, microprocessor microcircuit or microcomputer microcircuit within 1 ms after an electromagnetic pulse (EMP) or electrostatic discharge disruption, without loss of continued operation (ECCN 3D005)
3. Post-quantum cryptography (ECCN 5A002.a.4): control added on certain types of post-quantum cryptographic algorithms
4. Underwater transducers designed to operate as hydrophones (ECCN 6A001, amended note — the note previously located below Item paragraph a.2.g.4 to below the introductory Item paragraph a.2 was amended for better readability). This Note informs the public that Item paragraph a.2 "applies to receiving equipment, whether or not related in normal application to separate active equipment, and "specially designed" components therefore."
5. Air-launch platforms specially designed for space launch vehicles (ECCN 9A004.g)

Companies should carefully review the additions or revisions to these ECCNs to determine if an export license from BIS will be required to export the items or technology to specific destinations.

Preparing for additional US controls on "emerging technologies"

The US unilateral controls noted above have not been finalized, but companies that develop or work with the following types of technologies[6] should be prepared for any changes to the export regulations:

1. Biotechnology, such as: (i) nanobiology; (ii) synthetic biology; (iii) genomic and genetic engineering; or (iv) neurotech
2. Artificial intelligence (AI) and machine learning technology, such as: (i) neural networks and deep learning (e.g., brain modeling, time series prediction, classification); (ii) evolution and genetic computation (e.g., genetic algorithms, genetic programming); (iii) reinforcement learning; (iv) computer vision (e.g., object recognition, image understanding); (v) expert systems (e.g., decision support systems, teaching systems); (vi) speech and audio processing (e.g., speech recognition and production); (vii) natural language processing (e.g., machine translation); (viii) planning (e.g., scheduling, game playing); (ix) audio and video manipulation technologies (e.g., voice cloning, deep fakes); (x) AI cloud technologies; or (xi) AI chip sets
3. Position, navigation and timing (PNT) technology
4. Microprocessor technology, such as: (i) systems-on-chip (SoC); or (ii) stacked memory on chip
5. Advanced computing technology, such as memory-centric logic
6. Data analytics technology, such as: (i) visualization; (ii) automated analysis algorithms; or (iii) context-aware computing
7. Quantum information and sensing technology, such as: (i) quantum computing; (ii) quantum encryption; or (iii) quantum sensing

4 The Wassenaar Arrangement is a voluntary export control regime with 42 Member States that share and exchange information on the export and transfer of military and dual use goods and technologies. See Statement Issued by the Plenary Chair on 2018 Outcomes of the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies https://eeas.europa.eu/sites/eeas/files/wa_plm_2018_chair_statement_2018_plenary_6_dec_0.pdf.

5 84 FR 23886-99.

6 83 FR 58201-02.

8. Logistics technology, such as: (i) mobile electric power; (ii) modeling and simulation; (iii) total asset visibility; or (iv) distribution-based logistics systems (DBLS)
9. Additive manufacturing (e.g., 3D printing)
10. Robotics, such as: (i) micro-drone and micro-robotic systems; (ii) swarming technology; (iii) self-assembling robots; (iv) molecular robotics; (v) robot compliers; or (vi) smart dust
11. Brain-computer interfaces, such as: (i) neural-controlled interfaces; (ii) mind-machine interfaces; (iii) direct neural interfaces; or (iv) brain-machine interfaces
12. Hypersonics, such as: (i) flight control algorithms; (ii) propulsion technologies; (iii) thermal protection systems; or (iv) specialized materials (for structures, sensors, etc.)
13. Advanced materials, such as: (i) adaptive camouflage; (ii) functional textiles (e.g., advanced fiber and fabric technology); or (iii) biomaterials
14. Advanced surveillance technologies, such as face print and voice print technologies

New regulations may restrict not only where such technologies may be exported, but also the limit the disclosure of such technology to non-US persons in the United States working on such projects without an export authorization from the US Government (a "deemed export license"). This could limit collaboration within a multinational enterprise, between employees within the same company and with third parties such as universities and suppliers.

The passage of FIRRMA and the expansion of the authority of CFIUS will also have implications for investments in US technologies and mergers and acquisitions. US national security review of proposed transactions will be particularly rigorous for the technologies listed above, and CFIUS is authorized to stop or unwind any deal it feels would be contrary to the national security interests of the US.

Both ECRA and FIRRMA contain broad authority for the US Government to limit access to foreign nationals on technology that it considers critical to US interests. Companies should plan ahead to determine how this legislation will affect current research and development, as well as future investments with foreign partners. ■

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AEO in China – modernizing the program

In the previous issue of *TradeWatch* (Summer 2019) we explored the enhanced benefits of Australia's next generation Authorized Economic Operator (AEO) program, as part of a series about trade facilitation measures in Asia-Pacific. In this issue, we review the latest developments in AEO in China.

Continuous improvement

After a decade of review and consideration, China's General Administration of Customs (GAC) formally introduced the AEO program in December 2014. It was designed to combine various customs practices and supply chain security standards, with the objective to facilitate cross-border trading activities. The AEO program has been subject to continuous improvement, but core benefits remain the same, being:

- Lowered inspection rate
- Simplified procedures for documentation
- Prioritization during the clearance process

The historic rating system for the credit and risk management of qualified businesses was also revised, with the AEO system having four classifications of importers and exporters:

- Advanced Certified Enterprises
- General Certified Enterprises
- General Credit Enterprises
- Discredited Enterprises

Advanced Certified Enterprises and General Certified Enterprises can enjoy the core benefits of the AEO program when handling import/export formalities in China. Advanced Certified Enterprises are additionally offered mutual recognition by customs authorities in foreign jurisdictions, where applicable. Mutual recognition continues to expand, with China currently having entered into agreements with 36 countries or regions. This includes the 28 European Union (EU) Member States,[1] Australia, Hong Kong SAR, Israel, Japan, Korea, New Zealand, Singapore and Switzerland.

China Customs reform

Since the initial implementation of the AEO program, China Customs has been engaged in reform, both internally and with other government departments. Of particular note in this context is that, as part of the Integrated Customs Clearance Reform, the Commodity Inspection and Quarantine (CIQ) authority was merged into China Customs in early 2018.

In December 2018, to embrace these new developments, China Customs updated to the AEO certification standards with notable changes in the following areas:

Certification standards

Rather than apply a single certification standard, it has been recognized that the assessment criteria should be different for different types of organizations. The new assessment criteria differ for importers/exporters, customs brokers and service agents, respectively, allowing the certification process to be better tailored to the nature of the business under review.

Additionally, to assess the financial status of companies more comprehensively and objectively, a new standard considers factors such as cash coverage ratio, debt asset ratio, operating profit ratio and return on equity (ROE).

Integration of Customs and CIQ for assessing credit and risk management

With the introduction of new certification requirements, an updated AEO certification framework covering both Customs and CIQ operations has been created.

1 The EU Member States are: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom.

The CIQ used to operate a separate rating system for assessing the credit worthiness and risk management of companies. Reflecting the merger of CIQ with China Customs, the certification standards have been updated to include the following factors:

- China Customs must consider information related to inspection and quarantine operations when evaluating the credit status of importers.
- Any prior violation of CIQ rules and regulations for criminal liabilities will require a company to be categorized as a Discredited Enterprise.
- CIQ considerations have been added to the required management measures and requirements for criteria for Advanced Certified Enterprise, General Certified Enterprise and Discredited Enterprise status.
- If an AEO applicant is suspected of a violation of the relevant CIQ rules or regulations, its application will be suspended.
- If a certified enterprise is criminally charged with a violation of the CIQ rules or regulations, its AEO status will be terminated.

Encouragement of voluntary disclosures

China Customs has been promoting the use of voluntary disclosures, as part of a focus on encouraging companies to self-police their compliance and declare any errors. Previously, if a company made a voluntary disclosure and any penalty amount exceeded RMB50,000 (approximately USD7,000) this would be counted against its AEO status and could cause its categorization to be changed (with consequent impacts on the business). This threshold has been increased to RMB500,000 (approximately USD70,000), thus allowing companies greater scope for errors to be reported without them adversely impacting the company's AEO status. This change has been a positive move, for both the AEO and voluntary disclosure programs, encouraging companies to be proactive in managing their trade compliance.

Higher standards in assessment

As we have noted, China Customs has focused on improving the AEO program, in terms of introducing tailored assessment criteria, changing the application criteria and focusing on the AEO benefits. However, it is also noticeable that it is increasingly difficulty for businesses to pass the assessment by Customs, as the standards being applied are more stringent compared to the past, which is in line with international standards. China Customs is putting increased emphasis in the following areas in considering AEO status:

- Importers and exporters are expected to have tight controls on cargo safety management (e.g., cargo handling procedures, over- or short-shipment allowances, CCTV surveillance at delivery and in warehousing areas, etc.).
- Technology is playing a much greater role, with the new standards imposing requirements on both Advanced Certified Enterprises and General Certified Enterprises to utilize technology in managing trade operations (e.g., to record, monitor, and analyze trade data and provide early warning as appropriate, etc.).
- There is a greater focus on the suppliers and customers dealing with an AEO certified company, with the new standard requiring effective mutual supervision between companies as supplementary to the supervision by the customs authority itself.
- Overall, there is a higher expectation in terms of internal controls, with AEO applicants expected to reinforce the procedures for internal verification, internal audit, accountability and continuous improvement. For example, businesses must conduct internal compliance audits on a regular basis so that any potential issues may be discovered and can be addressed in a timely manner.

Where to now?

China Customs has embraced the AEO program as an integral part of managing trade compliance – as evidenced by the requirements for self-policing and the enhanced expectations for compliance across the supply chain for internal controls and the use of technology. As more companies come under the AEO program, those that are not in it will inevitably face increased scrutiny and may experience business impacts. It is increasingly clear that being part of the AEO program in China is now a necessity and not an option for businesses trading in the region. ■

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Is the customs audit environment in Asia-Pacific changing?

The Asia-Pacific region is a diverse one, with a combination of developed and emerging markets, large and small economies. In some countries, customs duty is still a critical contributor to government revenue and can drive the actions of customs authorities in addressing compliance and revenue protection. In other countries, trade facilitation is a critical driver. Therefore, we should not be surprised that a short answer to the headline question is yes … and no. However, it is more complicated than simply commenting by reference to a developed or emerging market, so let's explore the question in a bit more detail and understand how companies can be prepared.

What is changing — technology and data

Technology and the use of big data passes by no one. Across the region, it is standard for customs to use data in the process of identifying target importers for audit. Often, when selecting an industry sector for review, customs is now supplementing their sector data with information about an individual company's imports, performing a level of analytics even before the importer is aware that an audit is happening. At its simplest, customs is often up against timelines to open and close an audit, so preparation work before the clock starts ticking is of considerable help to customs, and analytics of importer's data identifies key areas for review. Across a number of countries, we see this particularly in the area of product classification.

Findings from audits are also being better used by customs. For example, we have seen customs using errors in classifications to be applied across the importers of similar description products, particularly other group companies of the audited importer.

The examples of how customs in Asia-Pacific are using data are too numerous to detail. But there are a couple of key points to note, as companies are getting to grips with technology and data analytics. An obvious comment is that customs has the aggregated data an importer previously provided in declaring their imports. Why is this an important point? It is because we often find that companies, or their service providers, such as customs brokers, have "spliced together" the required data for an import declaration from different databases within a company or from various different commercial documents. It is not unusual for customs authorities to have the only aggregated single set of import data. Certainly, the only data set that is readily available for analytics. This is why our clients will commonly request the historic data of their imports from the customs authorities, something that is readily available in an increasing number of countries in the Asia-Pacific region. A second key point is that, in the context of data and technology, customs has time on its side. Transactional import data is already captured. At this stage, it is often more about the customs authority's ability to use it. The statute of limitations in many countries allows customs to look back a number of years. Future data analytics skills of customs authorities can be applied to today's or historic transactions — and they are improving fast!

Key areas of focus

This is a case of "the usual suspects," being customs valuation, classification, product origin and duty reliefs. We will focus on each of these in turn:

Customs valuation

The focus, generally, continues to be additions to the price paid or payable, be it royalties, commissions, assists, etc. This is nothing new. We are seeing authorities be very aggressive in deeming all royalties as dutiable. Customs is being creative in trying to link manufacturing royalties with imported goods, even to the extent of linking a manufacturing royalty to the import of capital equipment from which the goods are domestically manufactured. In some countries, reference prices are used to challenge the import value of declared goods, alleging a relationship has influenced the price. Business transformations, which drive a price change, or indeed just regular price adjustments, can also provide a challenge. We see more companies becoming proactive in addressing price changes with customs, so as to avoid such challenges. It is also common now for customs to ask for transfer pricing documentation when conducting an audit, and transfer pricing adjustments are now increasingly a focus.

Classification

As mentioned above, this is a key area of focus from customs, which is increasingly using trade data analytics to identify inconsistencies and to find errors.

Origin

Customs investigating origin, particularly preferential origin, has seen a marked increase across the region. Apart from some obvious exceptions, such as Korean Customs, which has been focusing on auditing country of origin for a while, the issue of origin has tended to take a back seat in custom's order of priorities when conducting an audit. That's not to say that some companies have not been the subject of aggressive audits in the area of country-of-origin, it is more that customs has seen it as a challenging area to audit, often involving questions of the exporter and involving the customs authorities in the country of export, so they have gone after lower hanging fruit. Whether as a consequence of recent trade tensions where country-of-origin is a critical issue, or because customs has now identified this as a must-review issue, origin audits are now common. We see increasing inter-authority cooperation, and it is more common for an importing country audit team to travel to an exporting country to conduct a review. Regularly, customs is finding errors and companies are being faced with assessments and penalties. We are also seeing customs reject origin and impose penalties for what are administrative errors, e.g., not ticking a box on the origin certificate to indicate that there is third-party invoicing involved, even if this is self-evident from the combined import documentation and there are, otherwise, no issues of noncompliance. Also, in substance, the imported goods' origin are correctly declared. In the world of customs audits — this is the biggest growth area in the Asia-Pacific region!

Duty reliefs

Certain customs authorities, China, Thailand and Vietnam are examples, are more focused on this than others. Particularly where companies are importing goods for processing and subsequent export, there is the need to reconcile the imported raw materials with finished goods exported. The process of reconciliation has the potential for errors, which has become an area of focus. In this area, findings on a prior audit are a red flag indicator for a company to be reviewed again in the next audit cycle — so this is an area of repeat audit activity.

What has not changed?

In a number of countries, customs is still quick to assert positions, alleging errors or fraud. It differs markedly from country to country as to why this is the case. In some, it is simply an approach that would appear to be designed to elicit a quick settlement and closure to the audit. In others, there is a technical position asserted that is highly challenge-able and would appear unsupportable in fact or law — so it is more an issue of being aggressive technically, with consequent results. The process of challenging an audit finding can take a long time, disrupt business operations and involve a considerable financial commitment, not least because the full amount of duty and penalties may be required to be paid as a condition of appeal. Under the circumstances, it is not uncommon for companies to "settle."

What can companies do?

There are some simple guiding principles that will help companies in addressing the current customs audit environment:

- **Use of technology and trade analytics**
  This is now a "must." Companies cannot be in the position whereby customs knows more about their overall trade compliance than companies do themselves. The increasing use of trade analytics by customs, and its access to the aggregated data set of trade information, means companies are in a desperate catch-up at the time of a customs audit, if they are not already employing technology and analytics.
- **Service providers**
  Companies still outsource compliance-related activities to their service providers, such as customs brokers. This outsourcing does not shift their responsibility and liability. Companies need to have an enhanced focus on managing their service providers.
- **Settlement is a precedent**
  However tempting it may be to "settle" in an attempt to consign a customs audit to history, settlements can often create a precedent for future audits and rarely provide protection against additional assessments. Indeed, settlements can often be a road map for future audits and complications. Many customs audits will end up in a settlement of some nature – most do not go to appeal or court – but there should not be a rush to settle under the wrong terms, as this is often a short-term gain for long-term pain.
- **Act fast**
  There may only be weeks, possibly days, before a customs audit officer or team has made a determination of what they think is a finding and a potential duty assessment. The customs audit may be far from complete, or at least you may think so, before findings are being communicated and points of view are being locked down. It is critical that any premature or erroneous positions adopted by customs are quickly challenged, otherwise these can become the prevailing view that are harder to subsequently refute.
- **Escalate**
  Have an escalation protocol in place that quickly involves a trade professional, internal or external, in any customs audit. It is a common issue, linked with the prior point, that when a customs audit has progressed past a certain point, it is harder to bring facts and objective analysis to the process. It is also commonly the case that initial queries are handled by non-trade professionals, and responses are provided without an awareness of the implications.
- **Rulings**
  With countries in the region having, at least to some degree, implemented the Trade Facilitation Agreement, it has never been easier to obtain rulings. That's not to say the process is an easy one, but companies should know how rulings can bring certainty to their trade operations and minimize areas of potential conflict from customs audits.
- **Authorized Economic Operator (AEO)**
  Under different names, there are many schemes being operated across the region, and we have been reviewing them as part of TradeWatch publications. Taking advantage of these schemes does not eradicate customs audits and controversy management but being an AEO-certified company can help in the proactive management of customs compliance and provide considerable benefits.

Conclusion

There are challenges in generalizing situations, as each country's customs authority has different dynamics and approaches to customs audits. However, in Asia-Pacific countries, there are some clear trends. These include the use of technology and data analytics, together with country-of-origin as a key focus area under audit. While customs authorities are more capable in audit procedures, there are still "traditional" approaches being deployed, whereby customs is quick to establish a point of view and companies are encouraged to settle – whether facts and analysis are supportive or not. This combination of new and old is creating challenges for many companies. However, there are many steps a prudent company can take to maximize compliance and minimize the impact of customs audits. ■

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New Zealand's customs modernization – an update

It has almost been a year since New Zealand modernized its entire customs legislation with the introduction of the Customs and Excise Act 2018. Most provisions of the new act came into force on 1 October 2018 and were covered in an earlier edition of *TradeWatch*.[1]

A principal purpose for the rewrite of the customs legislation was to modernize the customs rules, considering current and future business models and making the legislation easier to understand. Consequently, a number of new services were made available to the importing community. In this article, we look at the success of the new measures and provide an update on audit activity undertaken by Customs. It is expected that official statistics will be published by Customs later in the year in relation to the new services.

1. Valuation rulings

It is now possible to obtain rulings on valuation matters. Previously, it was only possible to obtain rulings on origin and classification. However, we understand only one ruling application has been received since the inception of this new service. On an issue where companies are often keen to obtain certainty, why the low uptake?

Historically, it has been difficult to reach consensus with Customs on valuation matters. A 2014 Customs Appeal Authority case[2] concerning the importation of commercial aircraft illustrates the potential difficulty and protracted nature of dealing with Customs on valuation matters. As duty is generally not payable on commercial aircraft, it appears there was a protracted dispute for several years over GST. We would expect the GST should have been recoverable by the importer. Despite this, the dispute ended up in the Customs Appeal Authority. The importer was relying on industry-published values for each vintage of aircraft rounded down to the nearest million. In contrast, Customs argued that the agreed values in the lease contracts should form the basis of the customs value. Although the importer lost the case on procedural aspects, Judge P. F. Barber noted that "... Customs' valuation approach is too rigid in all the circumstances of this case and that I feel that the AVITAS value, which the appellant had adopted, is the most appropriate of a fairly unsatisfactory set of valuation options for these airliners."

The lack of interest in valuation rulings is likely to be at least partly attributable to the legacy of such experiences. Customs has indicated it would like

1 https://www.ey.com/Publication/vwLUAssets/ey-global-trade-tradewatch-dec-2017/$FILE/ey-global-trade-tradewatch-dec-2017.pdf

2 An Airline v Chief Executive of the New Zealand Customs Service [2014] NZCAA 9 (18 February 2014).

to see a successful valuation ruling being issued, which is a positive. Time, and a few test cases, will soon establish whether the business community is embracing and getting value from the valuation ruling process.

2. Storage of records

Prior to 1 October 2018, all customs records needed to be stored in New Zealand. Due to the very broad definition of "records,"[3] it is likely many traders with an overseas head office or finance function would have been in breach of their obligations.

A solution was implemented with the new act to allow traders to seek approval to keep records overseas or in the cloud. This is relatively an easy step to assist with compliance. However, Customs has advised that it has received approximately 27 applications from traders. This would suggest that the vast majority of traders have not taken advantage of this new measure.

3. Provisional Values scheme

The Provisional Values scheme was implemented to assist importers with post-import entry adjustments, such as royalties or transfer pricing adjustments. The introduction of the regime was a welcome change as the new act formalized how Customs practically dealt with the adjustments under the old legislation.[4]

Approximately 91 importers have registered under the new regime, which Customs views as a success. While there has been a reasonable uptake, there are still a large number of importers who have not registered and, as a result, are exposed to financial penalties.

For importers that are not registered under the regime and who make post-entry import adjustments, compensatory interest charges will apply (including to import GST shortfalls). While compensatory interest is intended to compensate the Crown for loss of revenue, the rate is more punitive, currently set at 8.35% per annuum.

Additionally, failure to disclose imports as provisional will expose importers to compensatory interest charges, irrespective of being registered in the regime. This should translate to an increased emphasis on monitoring broker compliance, although our experience is that importers often erroneously think that the use of third-party customs brokers will absolve them of their customs obligations and protect them from penalties.

It is expected that Customs, as part of its regular audit activity, will continue to monitor importers who should be registered for this regime. We discuss this further below.

4. Administrative reviews

Previously, where traders disagreed with a decision from Customs, the only ability to challenge the decision was through the Customs Appeal Authority.

Under the new act, traders are given the ability to request an administrative review on certain matters, being:

1. Duty assessments and amendments, including excise and provisional value assessments
2. Compensatory interest and late payment penalties
3. Administrative penalties

This is effectively a dispute resolution process that is administered by Customs. There is no cost from Customs in the event traders wish to undertake an administrative review.

Importantly, this does not prevent traders from appealing to the Customs Appeal Authority in the event a trader disagrees with the outcome of the review.

Earlier this year, the first six administrative reviews were all found to be in favor of Customs, which could have been a cause for concern. However, we now understand 14 administrative reviews have been completed and approximately 65% have been in favor of Customs. This trend is encouraging and is important to ensure administrative reviews are perceived to be independent and fair.

3 Section 59, Customs and Excise Regulations 1996.

4 Customs operated an "uplift regime" where certain importers were invited to disclose post-import entry adjustments.

5. Audit activity

Implementation of the new act took up significant Customs' resources. The implementation period finished on 31 October 2018. As a result, Customs' resources have been redirected

toward compliance and audit activity. As a result, we have seen a significant increase in audit activity and a change in focus on accuracy of import and export declarations.

Recently, Customs revealed a 90% compliance rate in respect of the audit of airfreight shipments.[5] A 90% compliance rate was identified as unsatisfactory as a 10% noncompliance rate still represented a significant number of shipments that are being declared incorrectly. It was acknowledged by Customs that this focus on compliance is partly attributable to a terror attack that occurred in New Zealand on 15 March 2019, when 51 people lost their lives.[6] A Royal Commission of Inquiry is currently under way in respect of the terror attack, investigating what happened in the lead up to the attacks on 15 March 2019, including the performance of state sector agencies such as Customs. It is also sobering, but not surprising, that recent Customs Appeal Authority cases[7] have focused on the importation of magazines for military style semiautomatic weapons.

Conclusion

Customs modernization brought legislation up to date and offered new services and opportunities to the business community to have greater certainty with their cross-border operations. But the emphasis was also for the business community to be proactive in managing their compliance, registering for regimes and in using these new services. The uptake, even in areas considered a success, would appear to be underwhelming.

It is important to consider that, even where there may not be any revenue at stake for Customs in respect of erroneous entries, protecting New Zealand's border is still a focus, with Customs' resources redeployed on managing compliance. It is important that traders are proactive and have robust procedures to ensure accurate entries are declared to Customs. As well as addressing internal processes, companies need to be managing and getting the best out of service providers such as their customs broker. ■

5 23rd Annual CBAFF Conference, 15 to 17 May 2019, Queenstown, New Zealand.

6 See https://www.justice.govt.nz/about/news-and-media/news/the-royal-commission-of-inquiry/

7 For example, Firearms Importer A v Chief Executor of the New Zealand Customs Service [2019] NZCAA 11 (25 July 2019).

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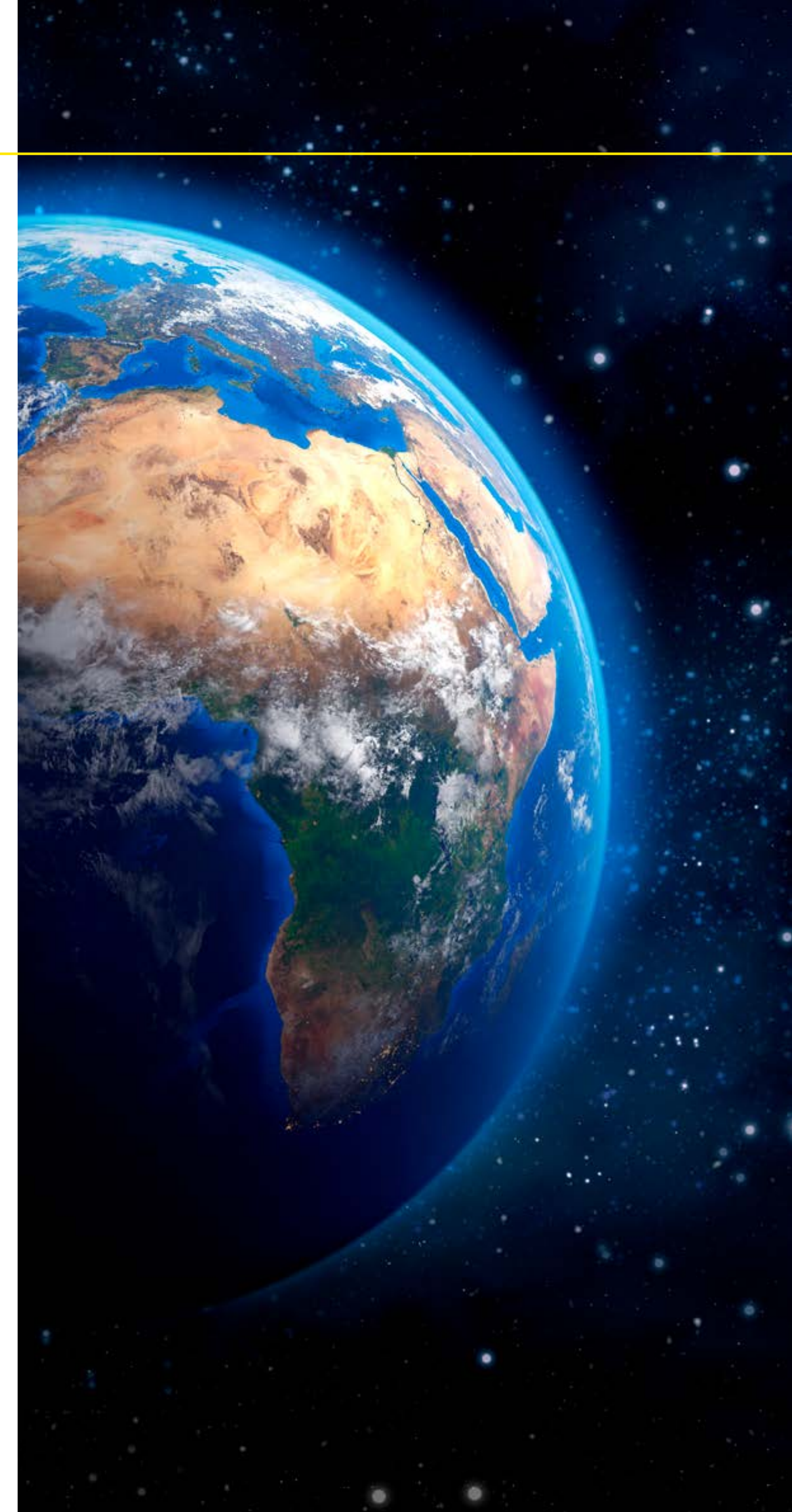


Africa Union launches operational phase of the Africa Continental Free Trade Area (AfCFTA)

Following the launch of the EAC-COMESA-SADC[1] FTA (Free Trade Agreement) on 10 June 2015, the Africa Continental Free Trade Area (AfCFTA) came into force on 30 May 2019. Since then, the Africa Union launched the operational phase of the AfCFTA, which will enable traders across Africa to make use of preferential trading arrangements offered by the AfCFTA by July 2020.

For the past four years after the signing of the EAC-COMESA-SADC FTA (comprising 27 African Member States) there has been no noticeable implementation of the FTA protocols. This has been attributed to economic and political polarization across the trade blocs and to a context in which most African countries currently still trade more with larger economies such as China, the EU and the US, than with their African counterparts.

The entry into force of the AfCFTA is considered a powerful response to this lack of intra-African trade as it aims to bring together more than 1.2 billion people and 55 countries with over US$3 trillion in gross domestic product (GDP), making it the largest free trade area in the world.

The launch of the AfCFTA will be paving the way for the establishment of a Continental Customs Union and eventually creating a single continental market for goods and services that will also allow free movement of business persons and investments.

By July 2020, traders across the whole of Africa will be able to make use of preferential trading arrangements offered by the AfCFTA. The immediate trade related benefits for businesses under the current agreement include, but are not limited to, the elimination of import tariffs on products throughout the supply chain, the gradual addressing of non-tariff barriers, a framework for mutual cooperation amongst customs administrations and increased transparency about applicable trade legislation.

Intra-African trade is bound to be expanded through better harmonization and coordination of trade liberalization, and challenges of multiple and overlapping memberships of already existing regional trade blocs will be resolved. It is expected that competitiveness at the industry and enterprise level will be enhanced through exploiting

1 East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA), and Southern African Development Community (SADC).

opportunities for scale production, continental market access and better allocation of resources. Indeed, the AfCFTA is considered to be the generator that will finally bring better hard and soft infrastructure to the continent enabling countries to connect in an appropriate way.

Respecting trade under the AfCFTA, it is important to note that, although significant progress has been made, certain implementation measures are still to be fully finalized, such as the tariff liberalization modalities and schedules, and the rules of origin. The negotiations on these topics are planned to be concluded and adopted early 2020, and the result of these measures will help to unlock the real potential for opportunities for all businesses active on the continent.

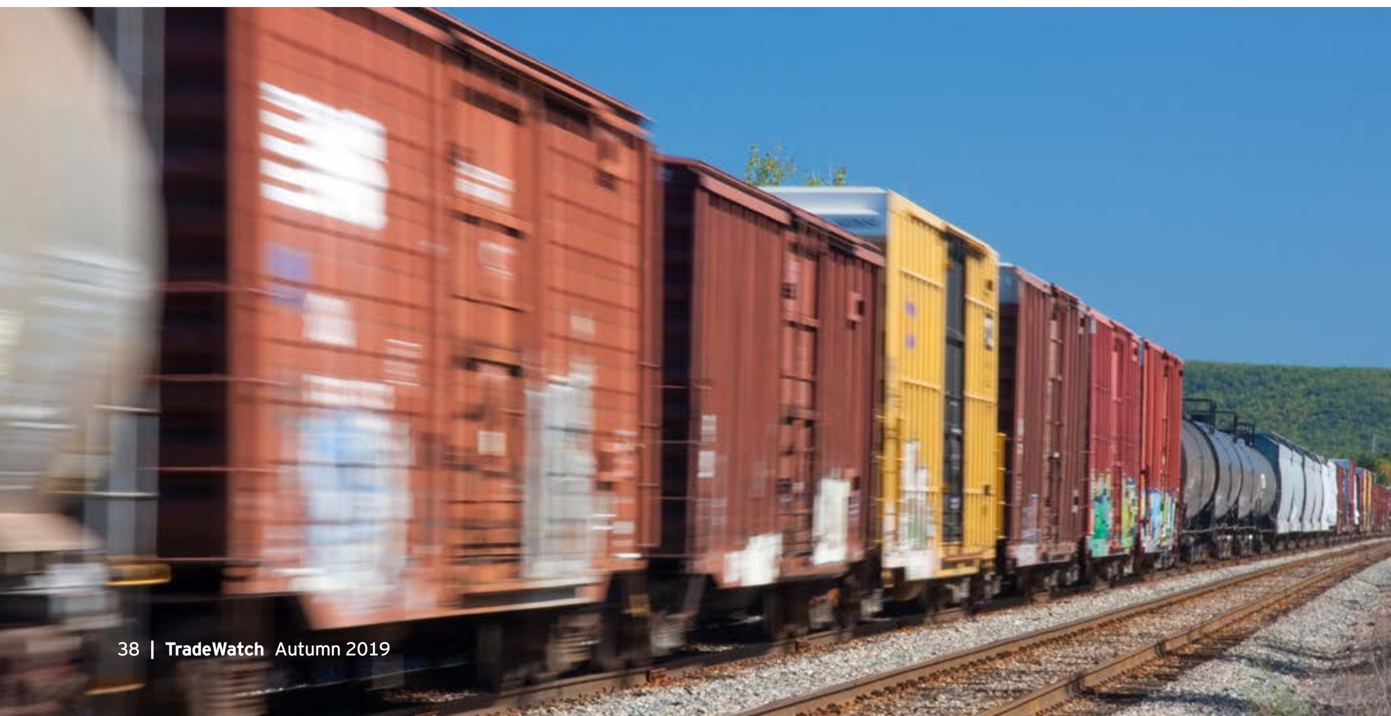
Since intra-Africa trade will be expanded each country will likely formulate suitable strategies and policies to leverage benefits that will accrue from the expanded markets. To compete with businesses in other countries in the liberalized environment, it is anticipated that local manufacturers in Member States will also be required to improve their product quality, increase production efficiency, become innovative, establish good resource allocation policies and integrate into the global value chains to.

Next steps

It is recommended that enterprises investing and operating in the countries in the AfCFTA area pay close attention to the scope and timing of the liberalization of tariffs on products in each country, as well as the timing of the final release and the specific criteria for certification of origin. Offshore investors planning to benefit from the FTA will need to set up legal entities and set up manufacturing concerns that enable qualification for origin if they are to competitively trade among and within other AfCFTA Member States.

In the meantime, enterprises should gain insight into their current supply chain models, sourcing options and go-to-market strategies to help shape opportunities and priorities once the AfCFTA becomes operational. The insight gained in the process, in combination with detailed projections, can pave the way to building optimized supply chains, delivering operational savings and competitive advantage.

After all, success occurs when preparation meets opportunity.



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Brexit update

State of play

In April 2019, the EU27[1] and the UK agreed a second extension of Article 50[2] to 31 October 2019.

Since April, the UK has appointed a new Prime Minister in Boris Johnson, while the EU has also held elections — the new European Parliament has had its first sitting, and the new European Commission takes office on 1 November 2019 — the day after the UK is due to leave the EU.

Mr. Johnson has previously verbally committed to ensuring the UK leaves the EU on 31 October. However, he has also stated that the chances of the UK leaving the EU without an agreement (known as a no-deal Brexit) are "vanishingly small." He attempted to suspend (known as "prorogue") Parliament for five weeks in September/October. However, prior to this, a cross-party group of members of parliament (MPs) managed to bring a bill (the "Benn Bill") into law, which is aimed at stopping the government from forcing through a no-deal on 31 October.

Since then, Johnson has said that that "he will strive to get an agreement in the national interest" — the next key date to look out for on this being the EU summit to be held on 17 October 2019. Meanwhile, on 24 September 2019, the UK's Supreme Court ruled that the prorogation was "null and void," and at the time of preparing this article, it remains to be seen what the Parliamentary consequences of this will be.

If there is no agreement between the UK and the EU, then the "Benn Bill" mandates that the Prime Minister must request a three-month extension on 19 October if a deal has not been approved.

However, such an extension needs unanimous approval from the EU27, and obtaining this agreement may be less certain than for previous extensions. Meanwhile, it remains to be seen whether the government will request or accept such an extension from the EU27, despite the new legislation.

As before, if no extension is agreed with the EU27 prior to 31 October, then a no-deal Brexit remains the default outcome.

1 The EU Member States excluding the UK.

2 Article 50 is a clause in the EU's Lisbon Treaty that outlines the steps to be taken by a Member State seeking to leave the bloc voluntarily.

No-deal impacts

Goods moving between the EU and the UK, which previously would have been "intra-community movements," will become imports and exports. This will put a financial and compliance burden upon importers, and a compliance burden on exporters. The new customs and border clearance requirements are the expected cause of delays at both UK and some EU border crossings in the event of a no-deal Brexit.

Meanwhile, while the UK has agreed a number of trade continuity agreements to mirror EU Free Trade Agreements (FTAs), access to preferential duty rates on imports into many non-EU countries (such as Canada) will be lost for UK exporters. For imports into the UK from non-EU countries, while FTA access may be lost, duty rates are expected to

be substantially lowered by the UK Government, at least in the short term. However, border delays may still impact UK imports from all locations.

Preparing for Brexit

For those preparing for Brexit, the key horizon in 2019 is a "no-deal" exit on 31 October. All other outcomes will keep goods moving unhindered in the short to medium term.

While the impacts set out in this article are generalized, each business will have specific factors affecting them and should ensure to plan accordingly – with 31 October only a short time away, if not prepared, businesses must act now to control business-critical risks and identify any triggers for further action.

Learn more

For more information please read here EY's latest insights on Brexit and the Government's *No-Deal Readiness Report*. Also register here to listen to EY's Brexit update webcast.

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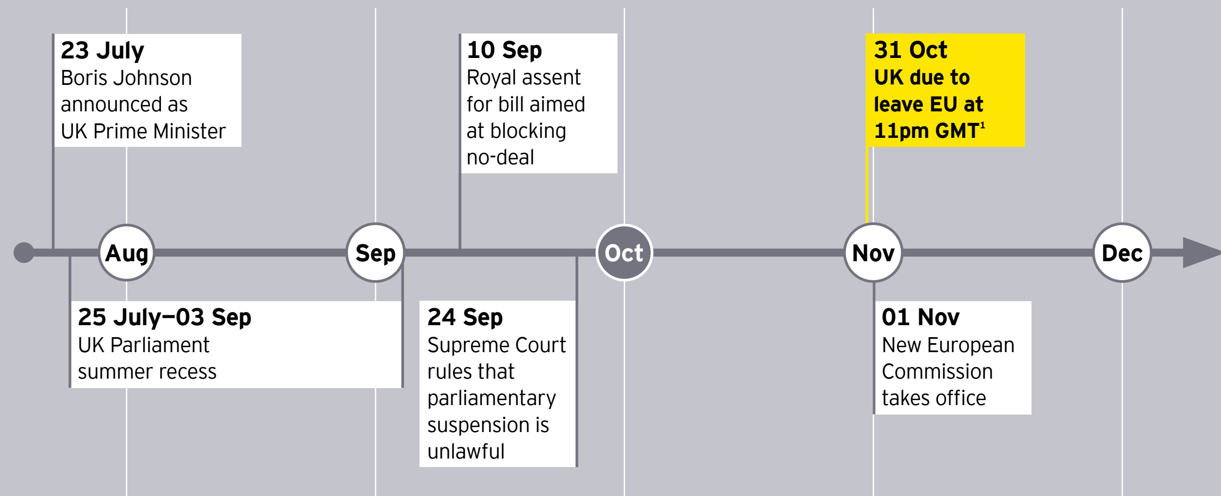
Where are we now?



Note: Accurate as at 25 September 2019

1 If the UK and EU ratify the treaty at any point before 31 October 2019 "the withdrawal will take place on the first day of the following month"

Brexit — what is happening in the Netherlands?

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With the Rotterdam port and Schiphol Airport as major points of entry and exit in trade between the EU and the UK, Dutch authorities started preparations for Brexit already in 2016. They estimated that some 35,000 Dutch businesses were involved in trade with the UK without being registered with customs. These companies thus had no previous experience with customs and had to be prepared for Brexit. The Dutch customs authorities organized road shows to inform businesses and published a lot of information on Brexit on their website.

As some 5 million additional customs entries/declarations per year are expected as a result of Brexit, it is clear that additional customs officers will be necessary to perform checks at the border. It was decided to hire 900 new customs officers to meet this demand.

At this moment some 550 officers have been recruited. Although these new officers will have received their training before 1 November, the target of 900 new officers will not be met.

In their communication with businesses they have made clear that from a customs perspective "every Brexit is a hard Brexit," meaning that in every Brexit scenario, be it a no-deal Brexit or a deal Brexit, customs formalities will be imposed in trade between the Netherlands and the UK after Brexit. Businesses need to prepare for this new situation.

Next to the initiatives of the Dutch customs authorities, several trade and logistical organizations and the authorities have joined forces and work together in an initiative called "Portbase." This solution for Brexit allows cargo to travel quickly to and from the UK — also after Brexit. If every link in the logistics chain participates and consistently uses Portbase to meet its obligations, transport through the Dutch ports can continue to flow without delay. This prevents delays due to customs formalities.

This solution for Brexit is 100% digital and automated. Virtually no paper documents are required in the port, both for delivery and collection. Portbase ensures that the correct party in the supply chain receives necessary information at the right time. The Dutch customs authorities are fully integrated in the Portbase solution. Both the handling of customs formalities and physical inspections of containers are covered and included in Portbase. Portbase has started a website https://www.getreadyforbrexit.eu, which provides information on Brexit and customs formalities in both the English and the Dutch language.

With these initiatives, the Dutch authorities expect to be as ready as they can for Brexit, be it a no-deal or a deal Brexit. ■

ECJ limits the assessment of import VAT in case of irregularities

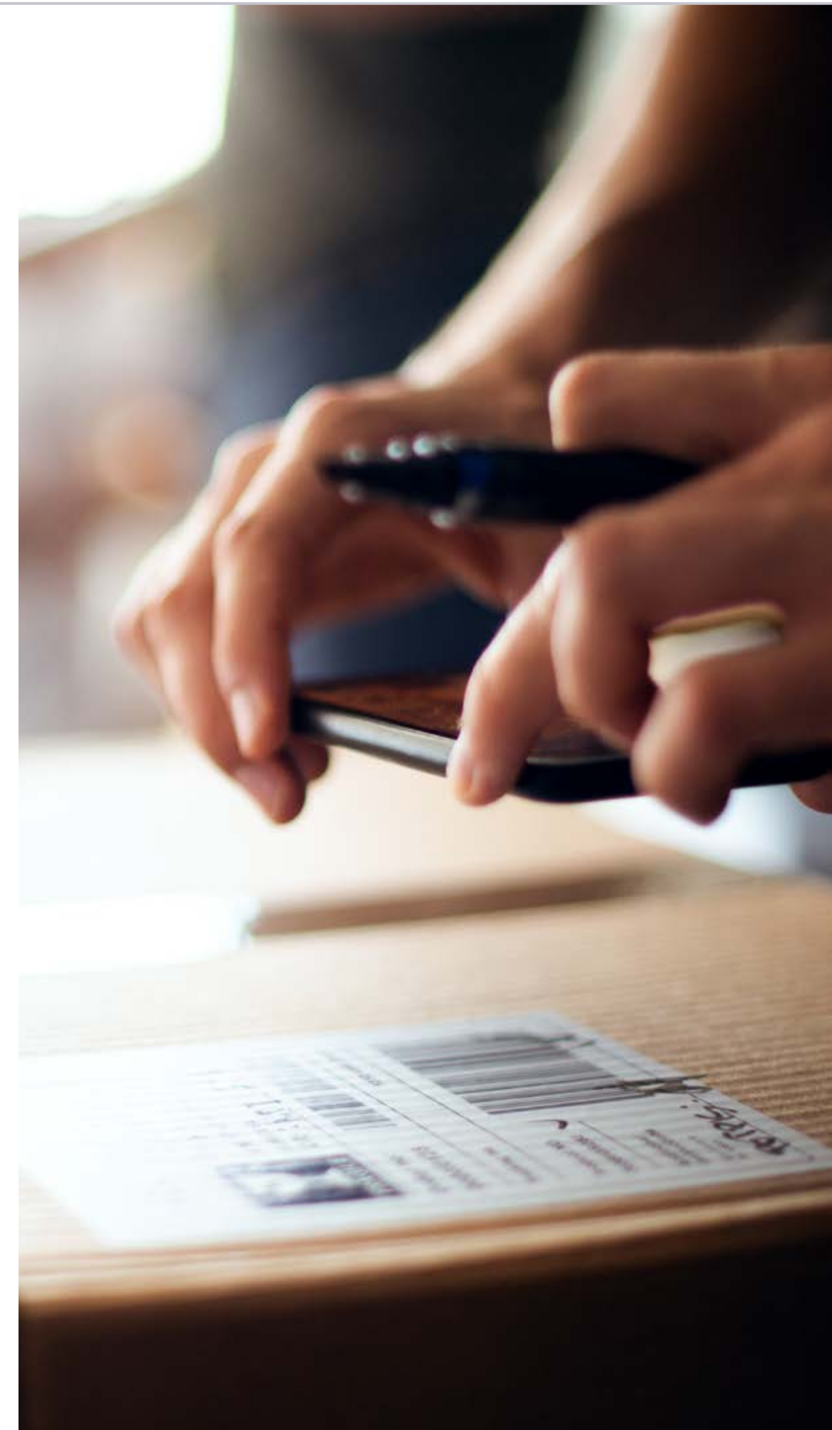
On 10 July 2019, the European Court of Justice (ECJ) decided in the FedEx case (C-26/18) that the assessment of import VAT is generally only permitted in the EU Member State where the goods have entered the economic circuit of the EU, or where it can be assumed that the goods have entered the economic circuit of the EU. Where this assumption cannot be made in one EU Member State due to irregularities in connection with customs procedures, but it can be proven that the goods were shipped to another EU Member State (final destination) for consumption, import VAT should only be assessed in that other EU Member State of destination, but not in the EU Member State where the irregularity occurred. In the following we will outline the case, the status in terms of its adoption, as well as practical consequences.

Moreover, the ECJ confirms that the assessment of customs duties does not automatically require the assessment of import VAT, i.e., the prerequisites for the assessment of customs duties and import VAT differ when it comes to assessments for irregularities.

Background of the case

Federal Express Corporation Deutsche Niederlassung (FedEx) is a German branch of Federal Express Corporation (US) and handles the express business of FedEx within Germany. As a value-added service to the transportation of goods, FedEx is also acting as customs agent arranging for the customs declarations of its customers.

In 2008 FedEx forwarded non-Union goods having origin of Israel, US and Mexico to consignees in Greece. These goods were transferred to Greece via Frankfurt Airport (Germany). Upon arrival in Greece, Greek customs authorities noticed that the shipments were affected by irregularities in connection with the Community transit procedure for air travel and informed German customs authorities accordingly. It was determined that some shipments were not correctly presented to customs in Germany (i.e., unlawful introduction into customs territory of the EU) while others were removed from place of storage without opening the respective transit procedure (i.e., removal from customs supervision). Consequently, German customs assessed customs duties and import VAT on these shipments.



FedEx appealed the assessment notices regarding the assessment of import VAT and argued that import VAT qualifies as an excise tax that can only be assessed in the Member State where the goods enter the economic circuit of the EU for its consumption. Due to the proven release of the goods for free circulation in Greece, the assessment of import VAT in Germany is unlawful.

Essence of the ECJ decision

Considering the ongoing jurisdiction in terms of the assessment of import VAT in case of irregularities (e.g., ECJ of 2 June 2016, C-226/14, C-228/14, Eurogate Distribution and DHL Hub Leipzig; ECJ of 1 June 2017, C-571/15, Wallenborn Transports), the ECJ was requested for a confirmation whether:

- An import according to Art. 2 para. 1 letter d and Art. 30 EU VAT Directive requires that the goods have actually entered into the economic circuit of the EU, or whether the mere risk that the goods may enter the circuit is sufficient.

And

- In case the import requires the goods to enter the economic circuit, does the entry occur already if an irregularity is discovered, or only where due to the irregularity it can be assumed that the goods have entered the economic circuit of and have been consumed in the EU Member State in which the irregularity occurred.

The ECJ did not explicitly comment on the "mere risk" but stated in its judgment that it is generally in line with VAT and customs law to assess import VAT at the time an irregularity concerning customs procedures occurs (i.e., at the time of removal from supervision or the unlawful introduction into the customs territory of the EU).

However, where it can be proven that the goods have been forwarded to another EU Member State and entered the economic circuit of that other EU Member State (i.e., for being consumed there), the import VAT can only be assessed in that other EU Member State of consumption, but not in the EU Member State where the irregularity occurred.

In this respect the ECJ has confirmed the following legal presumptions, which need to be considered for the evaluation whether import VAT should be assessed in the Member State where the irregularity occurred:

1. Goods introduced into the territory of the EU from a third country are intended for consumption and, therefore, intended to enter the economic circuit of the EU
2. Where the goods are placed under certain arrangements (e.g., customs warehousing, external transit), it is assumed that the goods are not intended for consumption, although the goods physically entered the EU
3. Where the legal conditions to make use of such arrangements have been breached, it must be assumed that the goods entered the economic circuit of the EU

However, each presumption can be rebutted by the parties involved. Presumption 3 can be rebutted by proving that the goods have not entered the economic cycle of the EU respectively of the EU country of irregularity. In addition to the earlier cases mentioned above, the ECJ confirmed in the FedEx case that this does not only apply where the goods have been shipped to a country outside of the EU, but also to another EU Member State where the goods have been customs cleared.

Current status and practical implications

The FedEx case is of interest for each customs operator that has been assessed import VAT due to irregularities, but is not entitled to deduct such import VAT as input VAT.

In particular, this applies to logistic entities who are involved in the process of customs handling (e.g., as indirect representative) and, thus, become liable for any import duties (customs duties, excise duties, import VAT) in case of irregularities. Those entities usually do not have the right to dispose over the goods at the time of importation and are, therefore, not entitled to deduct the import VAT as input VAT (ECJ of 25 June 2015, C-187/14, DSV Road A/S).

Concerned customs operators should review whether they incurred any import VAT due to irregularities for the periods not yet time-barred, and whether those cases meet the requirements for a refund based on the principles set by the ECJ, i.e., it can be proven that the goods did not stay in the EU Member State of irregularity but were shipped to either another EU Member State or a country outside of the EU.

The ECJ did not further comment on the requirements of how to prove that the goods have not entered the economic cycle in the EU Member State where the irregularity occurred. Thus, it can be expected that the different EU Member State might set different specifications in this respect.

However, such specifications have to be in line with the principles set by EU VAT and customs law (principles of neutrality and proportionality).

The shipment to the destination could, e.g., be proven via:

- Track and trace documentation issued by the logistic entity
- Physical checkpoints created by logistic entities (e.g., physical scans)
- Virtual checkpoints created by logistic entities
- Customs documents issued by the final destination
- Confirmations of the consignee about the receipt of the goods, etc.

The German customs authorities have not yet commented on the FedEx case, and it is not expected to happen soon. However, based on first discussions with the German customs authorities, it can be expected that a rather strict interpretation will be followed on what is accepted as sufficient proof. This means that German customs authorities might rely on "official" documents, such as customs clearance documents issued by customs authorities, and might not accept any documentation created internally. The question of which type of documents may be sufficient proof, is expected to become subject to subsequent court action. The reasoning is that the ECJ commented in cases of VAT-exempt intra-community supplies that a holistic view to value all available facts and circumstances must be taken so that in the end, depending on the circumstances of the individual case, even freight bills/manifests, documentation confirming transportation to another EU Member State by a logistic service provider and other types of records and documentation might be acceptable proof.

Customs operators that have had assessments of import VAT that was not deductible in the period that is not yet time barred by statute of limitation (regularly three years) are advised to review the underlying cases and evaluate the chance to file import VAT refund applications.

As a final note, EY professionals notice that it cannot be excluded that customs authorities may find reason not to apply the case law, and finally the ECJ may come to divergent opinion in a subsequent case since – despite good logic arguing applicability of the principles of excise tax to import VAT – the current legal conclusion may be subject to technical and systematic inconsistency. ■

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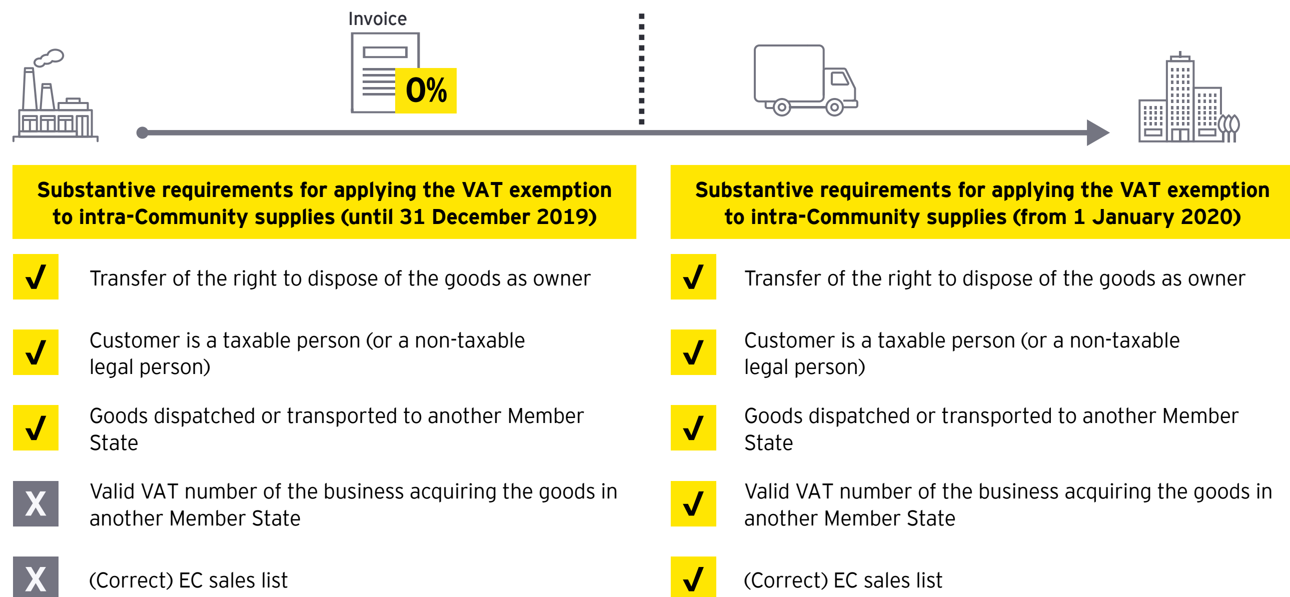
EU quick fixes – the impact on intra-EU trade of goods

New VAT rules regarding cross-border supplies of goods will enter into force on 1 January 2020. These rules could have a big impact on the VAT position and compliance obligations as regards the intra-EU trade of goods. These changes – commonly referred to as the "quick fixes" – relate to:

- The (substantive) conditions for applying the VAT exemption on intra-Community supplies
- Proof of intra-Community transport of goods
- Transactions related to call-off stock
- Application of the VAT exemption to a specific supply in EU cross-border chain transactions

In this article the changes are briefly set out, and analysis is provided from an EU perspective.

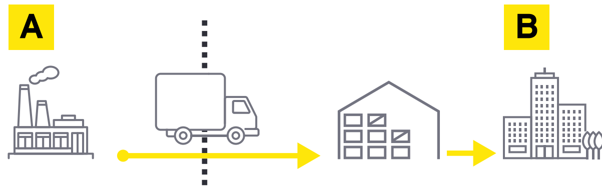


Actions to be taken/considered

Issues	Actions	Actions II
The current practice regarding evidence supporting the zero rate will be continued. The consequence of not possessing the proper documents for evidence can be rejection of the application of the zero rate and assessment of local VAT on that transaction.	Evaluation of the current available documentation concerning cross-border transport of goods	Consider in which EU Member States the evidence presumption could lead to a simplification
	Review of the current process of gathering the required documentation and assess whether these are enough to demonstrate the applicability of the VAT exemption to intra-Community supplies	Assessment of whether the current processes and existing documentation are sufficient for the application of the VAT exemption
		Possible adjustments of contractional provisions and processes

Simplification for call-off stock transactions: introducing harmonized rules at EU level

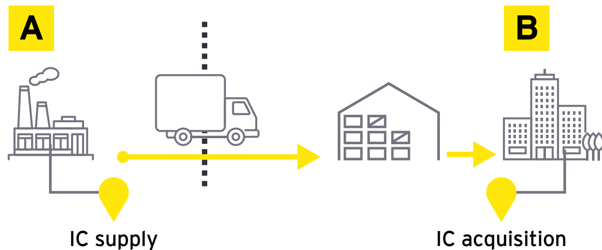
The principle underlying call-off stock



Supplier transfers goods to a stock location in another Member State for a known intended purchaser, without transferring the ownership of the goods at the time.

Purchaser has the right to take the goods from the stock at his own discretion after which a supply of goods takes place (from a VAT perspective).

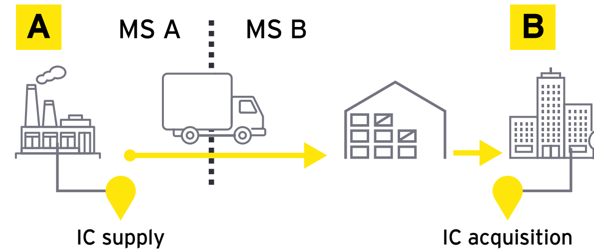
Existing simplified call-off stock arrangement in the Netherlands



Simplified arrangement for call-off stock transactions in the Netherlands (as Member State or arrival)

- No taxable transfer of own goods at the time of transport of the stock to the Netherlands
- Intra-Community supply/acquisition of the goods in the Netherlands at the time when the purchaser disposes of the right to act as an owner of the goods (i.e., at moment of call-off)

Uniform EU rules for call-off stock from 1 January 2020



Caution

In certain situations you still need to report a transfer of own goods!

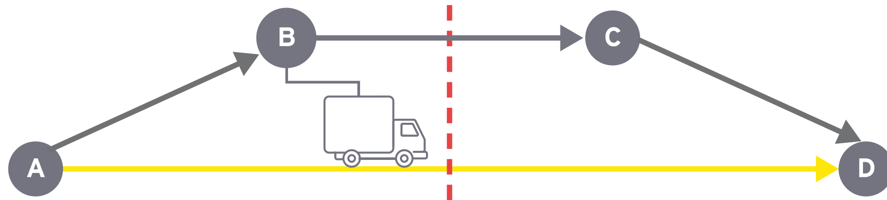
VAT status of parties	Characteristics of transaction	Filing/reporting obligations
✓ A and B are VAT taxable persons	✓ Goods transported from one Member State to another by the supplier or on his behalf	✓ Transport recorded in a register by the supplier
✓ A is not established in the Member State of arrival	✓ Goods should be supplied (called-off) after arrival within a period of 12 months	✓ Identity and VAT number of the intended acquirer mentioned in the EC Sales List of the supplier at the time of the physical cross-border transfer of the goods
✓ At the time of the transfer of goods by A, B is VAT registered in the Member State of arrival of the goods	✓ Acquirer's identity and VAT number are known by the supplier at the time when transport commences	✓ Acquirer records the cross-border transfer of the goods in its register

Actions to be taken/considered

Issues	Actions	Actions II
Currently, some EU Member States do not have simplification rules for call-off stocks. As a result, suppliers must VAT register to report the transport of own goods in the Member State of arrival of the goods. As the simplification must be applied uniformly throughout the EU, some reporting obligations will disappear.	Review current supply chains to identify where the new rules have an impact and where this could possibly lead to cost saving	Review the current supply chain and to avoid unnecessary VAT registrations
	Ensure that the business is ready to report call-off stock arrangements in the relevant registers and review if this obligation could be directly implemented into your ERP system	Build an application in ERP system to remain compliant with the obligations to keep a register
	Consider whether relevant exceptions (that could lead to a local VAT registration obligation) apply in your situation and — if possible/preferred — change set-up/contracts	Review/assessment of the existing contractual conditions

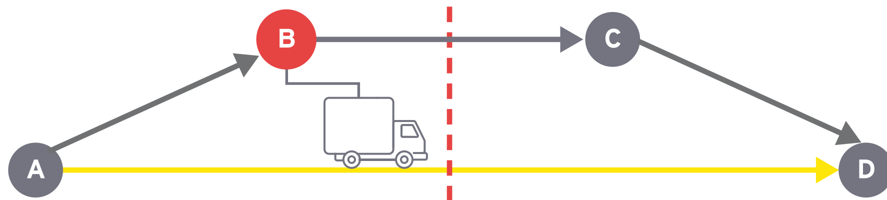
Application of the VAT exemption to a specific supply in EU cross-border chain transactions:
Harmonized rules to allocate the transport to one specific transaction

Applying VAT exemption in chain transactions until 31 December 2019



- Only the supply to which the transport must be attributed can be zero rated as IC supply.
- No rules for attributing the transport of goods in the VAT Directive.
- Difficulties in determining which supply qualifies as an IC supply when the transport is done by or on behalf of parties "in the middle" of the chain.

Applying VAT exemption in chain transactions from 1 January 2020



Specific rules to allocate the transport in chain transactions:

- Starting point is that the transport is performed or on behalf of another party (other than the first supplier). The new rules have no effect on transactions where the transport is arranged or performed by the first supplier.
- Transport will be attributed to the supply that is made TO the intermediary operator.
- Exception: transport attributed to the supply BY the intermediary operator if he has communicated his supplier the VAT number issued by the Member State of dispatch of the goods.
- 'Intermediary operator' means a supplier within the chain other than the first supplier in the chain who dispatches or transports the goods either himself or through a third party acting on his behalf.

Actions to be taken/considered

Opportunities	Actions
Incorrectly applying the VAT exemption may lead to the assessment of local VAT from the supplier.	Determine whether you are currently part of chain transactions in which the transport of the goods has not been done by or on account of the first supplier. In that case, it is recommended to assess the impact of these changes.
It could be that in certain cases in which the zero rate is currently applied to a specific transaction, the new legislation may affect this treatment. ■	

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Need for action in structures comprising non-European exporters, developments in Germany

This article is a follow-up to the previous issue of *TradeWatch* (Summer 2019) in which we discussed the significant amendments in customs law related to the redefined definition of the customs exporter. We would like to give an update on the state of play in Germany and current administrative practices of the German customs authorities.

Furthermore, we elaborate on the effects on supply chains, especially comprising companies acting in so-called principal structures, where a non-European enterprise (e.g., a Swiss principle entity) assigns goods located in the EU (here: in Germany) for exportation to non-European countries. In most cases, the non-European principle uses the services of an EU-based toll manufacturer to produce or purchase goods on the domestic market and then stores them in a central warehouse or distribution center until the goods are requested for stock transfer or sale or use on the EU or a non-EU market.

After the Union Customs Code (UCC) was implemented in May 2016, the definition of the term customs exporter was redefined on 31 July 2019 (Art. 19 no. 19 b) Reg. (EU) 2015/2446 (UCCDA). Just recently, the German customs administration has now also adapted their internal administrative guidelines on the new legal situation. It needs to be mentioned though that the current internal administrative guidelines of customs authorities include contradicting advice and leave room for interpretation. However, in accordance with the rules in primary law, non-European enterprises shall no longer act as an exporter for purpose of export customs clearance. First initial experience confirms that the legal application of (regional) customs offices follows the new internal administrative guidance (with remote pace). While some authorities still accept export declarations showing a non-European enterprise as exporter, the number of customs offices that are refusing such declarations seems to be increasing.

The comparison below shows that the new definition in force since 31 July 2018 will offer more flexibility in determining the exporter.

Old definition (since May 2016)	New definition (since August 2019 included in German customs internal guidelines)
EU-established company	
Non-European exporters had to be represented indirectly in the export declaration by a person (company) established in the EU.	▸ Person who has the power to determine and has determined that the goods are to be taken out of the customs territory of the EU ▸ Where an exporter cannot be identified under the above-mentioned arrangements, the exporter is a contracting party established in the customs territory of the EU pursuant to the contract under which the goods are to be taken out of the customs territory of the EU

Especially when non-European enterprises are involved in the transaction or supply chain, it is often unclear which party has the property of export determination or actually operates the exports. This includes, e.g., placement of orders for stock transfer or stock order, making shipments ready for customer, picking and packing, assignment of forwarders, conduct of the customs declaration and clearance process, conduct of export-related trade compliance checks, etc.

Due to the new definition, German customs authorities agree that the property of export determination and being customs exporter can be granted by contractual arrangements to a specific person. Therefore, an agreement can be reached between the relevant persons as to who fulfills the determination that the goods are to be taken out of the customs territory of the EU. Having in place such contract can rule out situations of doubt and provides documentation that can be provided to customs authorities upon request.

Effects on corporate supply chains

As noted, first customs offices in Germany no longer accept export declarations if (according to the old application of law) a non-European enterprise was declared as the customs exporter. This also applies to scenarios in which the German party submitting the customs declarations is still in possession of an authorization for simplified export declaration containing applicability for scenarios where a non-European party is/was the customs exporter (which may not yet have been revoked by the customs office, despite the new application of law). It seems only a matter of time until the new application of law will be manifested consistently in administrative practice, and export declarations showing a non-European enterprise as customs exporter will no longer be accepted. Noteworthy, also doubts about the person declared as customs exporter can lead to questions of the customs office of export to the customs declarant, and the (temporary) nonacceptance of customs declarations can lead to a disruption of the ability to export.

The nonacceptance of export declarations directly leads to disruptions in the supply chain, as the goods cannot be exported smoothly. Consignments destined for export literally stop. As a result, the alternative of an export declaration in the normal two-stage export procedure leads to slower processes, more effort and more costs. The export declaration of an incorrect party as exporter and, in particular, the unlawful use of the authorization for the simplified export declarations can also be sanctioned as an administrative offence.

Check-list to adapt the export customs declaration set-up

To avoid risk arising from the new application of law or administrative practice – namely the disruption of the supply chain due to the rejection of export declarations – companies are required to investigate which business transactions lead to the export of goods and how the customs exporter can be determined in each of the relevant transactions by reviewing the current contractual and operational process conduct in relation to exports.

The following course of action has proven itself in recent practice:

- Analysis of business transactions leading to the export of goods and the current declaration of the customs exporter

- Analysis of rights and obligations of individual participants according to existing contracts, e.g., with regard to the commissioning of transport service providers
- Analysis of the operative processes regarding customs clearance, trade compliance and other legal audits, especially for the warehouse and shipping processing of goods
- Assessment under customs law based on the new application of law
- If necessary, adaptation of operational processes and/or conclusion of a contract that grants an EU-established party (which is to act as customs exporter) the power to determine that the goods are to be taken out of the customs territory of the EU (whereby the organizational/procedural design of the export processing must of course give substance to the contract)
- Transparent coordination with the customs authorities in the specific case
- If necessary, adaptation of existing customs authorizations for the simplified export procedure or application for new customs authorizations
- Where required, disclosure exempting from fines pursuant to Section 22 (4) Foreign Trade Act to protect against allegations of past declaration of a false exporter and risks of fines to that effect

Obviously, the project approach must be examined in each individual case and adapted as necessary.

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Recast of the EU Dual-use Regulation

The EU Dual-use Regulation[1] covers the EU regime for the controls of exports, transfer, brokering and transit of dual-use items. In 2014, The European Parliament ("Parliament"), the European Commission ("Commission") and the European Council ("Council") issued a statement regarding the review of the EU's current dual-use regime. The main reasons for reform are the technological developments that took place over the years, the increase of complex cross-border trade flows and intangible technology transfers, and the lack of uniform application of export controls at EU Member State level.[2]

Following a green paper (published in 2011), a stakeholder consultation and an impact assessment, the Commission adopted a proposal for the recast of the EU Dual-use Regulation in September 2016.[3] This proposal would bring many changes to the current regime, significantly impacting businesses, positively, but potentially also negatively. In January 2018, the Parliament adopted its amendments to the Commission proposal.[4] Only recently, in June 2019, did the Council adopt its negotiating position on the proposed recast of the regulation.[5] On the basis of this position, the Council will start negotiations with the Parliament, eventually resulting in the final text of the new EU Dual-use Regulation.

Main changes introduced by the proposal

Below we highlight the main changes that the Commission's proposal would bring. Where relevant, we will highlight the initial position taken by Commission, as well as Parliament's proposed amendments and the position taken by the Council.

Human rights

The main proposed change relates to the imposing of controls regarding certain cyber-surveillance technologies that may be used to violate human rights. The Commission proposed that five cyber-surveillance technologies are to be covered by the Dual-use Regulation: mobile telecommunications interceptions equipment, intrusion software, monitoring centers, lawful interception systems and data-retention systems, and digital forensics. As monitoring centers and data-retention systems are currently not included in the internationally agreed dual-use controls, these would be added to the control list (Annex I), in a new category 10. This control would only apply in the EU, leading to a competitive disadvantage for EU businesses compared to producers of similar products in other regions (e.g., China, US). The Commission also proposed to expand the definition of dual-use items, by adding cyber-surveillance technology to this definition. As a result, non-listed cyber-surveillance technology would be covered by the catch-all controls of Article 4 of the EU Dual-use Regulation.

1 Regulation (EC) No 428/2009 of 5 May 2009.
2 COM(2014) 244 final, 24 April 2014.
3 COM(2016) 616 final, 28 September 2016.
4 2016/0295 (COD), 23 January 2018, TA/2018/6/P8.
5 2016/0295 (COD), 5 June 2019, ST 9923 2019 INIT.

The Parliament generally agrees with the proposed changes in relation to human rights, and in some sections even adds substantive clarifications. This is not surprising, considering the legislative resolutions it had already issued in 2015.[6] In these resolutions, Parliament explained that technological systems can be misused as tools for human rights violations through censorship, surveillance, unauthorized access to devices, jamming, interception, and the tracing and tracking of information and individuals. The Parliament lists potential violations of the rights of freedom of expression, access to information, the right to privacy and freedom of assembly and association. The Parliament included this in the definition of cyber-surveillance items in its amendment of the Commission's proposal.

The Council, on the other hand, has removed several references to human rights and cyber-surveillance technology controls. The Council also removed cyber-surveillance technology from the definition of dual-use items, because cyber-surveillance technology is not covered by the catch-all controls. The Council also removes category 10 from Annex I. This approach would be more in line with the dual-use items lists that apply internationally, based on multilateral agreements (e.g., the Wassenaar arrangement).

Also, the reference to violations of human rights is removed from the catch-all provision. Possibly the Council wants to stick to the current provision: Article 8. Based on that provision, EU Member States *may* prohibit export of certain non-listed, dual-use items for reasons of human rights considerations.

Due diligence

In relation to the catch-all provision, the Commission added that the exporter has an obligation to exercise due diligence.

In addition to that, the Parliament introduces a new recital and adds a definition of "due diligence." The Parliament states that even though the responsibility for deciding on export authorizations lies with the authorities, an effective EU export control regime implies that economic operators should exercise due diligence. The Parliament refers to international guidance regarding due diligence (OECD Guidelines and UN Guiding Principles). The Parliament also added a definition of due diligence.

The Council removed said recital and definition and removes the reference to due diligence in Article 4 (the catch-all provision).

Export authorizations

The Commission proposal introduces several new EU general export authorizations to facilitate trade. The general export authorizations EU007, based on which low-value shipments would be exempt from the export authorization requirement, and the EU010 (for "other dual-use items") proposed by the Commission, are not upheld by the Council. However, the Council does agree with a new general authorization for intragroup transmissions of software and technology, and a new general authorization for encryption items. The latter is already applicable in several EU Member States as a national general export authorization.

6 2015/2037(INI), 21 May 2015, T8-0215/2015, and 2014/2232(INI), 8 September 2015, T8-0288/2015.

In its proposal, the Commission introduces a global export authorization for large projects, which can be valid for a period of four years. The Parliament and the Council agree with this.

The Commission also proposed that the use of global export authorizations (covering multiple items, export transactions and destination countries), should be subject to the implementation of an effective internal compliance program (ICP). This means that having written procedures and enough internal controls in place becomes more important. The Parliament even introduced the possibility to have the ICP certified by the competent authorities. This was, however, removed by the Council, which states that the authorities may require an exporter to have an effective ICP in place. Also, according to the Council, ICP requirements relating to the use of global authorizations should be defined by the Member States.

Exporter established outside the EU

Where the exporter is established outside the EU, the competent authority for granting export authorizations is the authority in the country where the goods are located. This is introduced by the Commission. Currently, in principle, non-EU entities cannot apply for export authorizations in the EU. The Council upholds this but does not agree with the Commission that non-EU exporters should be able to obtain global authorizations. The Council suggests an amendment, stating that a non-EU exporter should only be able to obtain individual authorizations (i.e., single authorizations per export transaction).

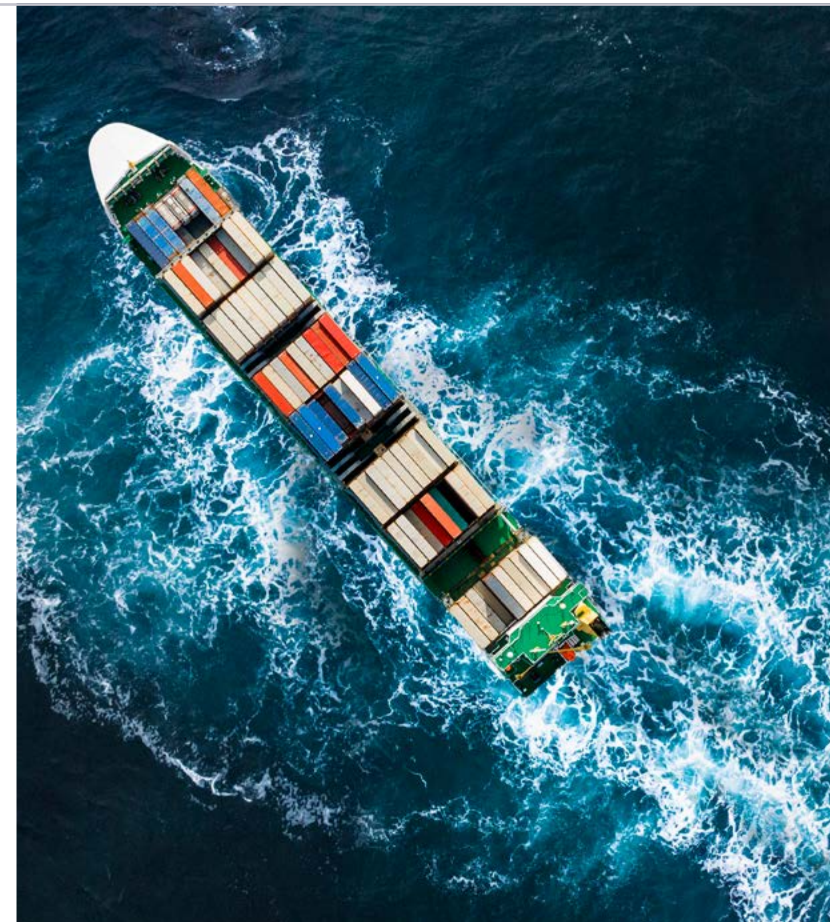
Brokering

Brokering services in relation to dual-use items are already subject to export controls. A brokering service is the arrangement of transactions for the supply of dual-use items from a third country to any other third country, or the selling or buying of dual-use items that are in third countries, for their transfer to another third country. Currently, only *EU-established entities* that act as "brokers," should adhere to these controls. To reduce the risk of circumvention of these controls, the Commission extends the definition of "broker" to subsidiaries of EU-established entities, and to brokering services supplied by third country entity from within the EU territory. The Council changed the wording, but the new wording still reflects that non-EU entities that carry out brokering services from the customs territory of the Union into the territory of a third country, are considered "brokers," and therefore fall under the EU controls.

What's next?

The Council and Parliament will now negotiate on the final text of the new Dual-use Regulation. Considering that 571 out of 629 Members of the European Parliament voted in favor of the Parliament amendments (29 voted against and 29 abstained) and considering the substantial differences between the Parliament's amendments and the Council's basis for the negotiations, these negotiations may be very challenging. It especially remains to be seen to which extent cyber-surveillance items will be controlled under the new Dual-use Regulation.

We will provide updates on the legislative process and the final text of the recast of the EU Dual-use Regulation in future editions of *TradeWatch*.



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Thinking outside the zone

In recent months, free ports have raced up the UK Government's agenda. It is promoted as something businesses should be looking forward to in a no-deal Brexit scenario. At the time of this article's publication, the free port initiative remains topical, yet discussions on it so far often lack substance.

This is an opportunity for businesses with UK operations to embrace something new. The article examines free zones in a new light, starting from what problems are pertinent post-no-deal Brexit, and how free zones can help alleviate these challenges to benefit businesses, government and the UK economy through the effective usage of existing technological solutions.

Free ports, free trade zones and special zone are a selection of names given to areas that are physically located in a country but considered outside the country for customs purposes. This article will not define what post-no-deal Brexit free zones are, so as not to limit its potential.

If your business would benefit from this, now is the time to shape how free zones are to be created and managed.

What could the benefits be?

There is a range of benefits for different stakeholders. As such, everyone must work together to introduce policies that can manage post-no-deal Brexit free zones effectively. A few examples of benefits are listed below.

Benefits for UK businesses

If post-no-deal Brexit free zones are introduced and managed correctly, they can be an effective tool helping SMEs to benefit from a reduced administrative burden. For businesses of all sizes, managing their import and export activities is burdensome and time-consuming.

When businesses operate special customs procedures, such as bringing raw materials into the UK with customs duty and import VAT suspended for manufacturing, this burden is even higher due to the need to meet stringent administrative requirements.

Unfortunately, the special customs procedures are more suited for large businesses with sufficient human and monetary resources, rather than SMEs. With a post-Brexit in a no-deal outcome, the number of businesses involved in importing and exporting will increase on an exponential scale, as businesses will have to carry out these procedures for goods coming from and going to the EU 27. The need to help SMEs has never been higher.

Benefits for the UK Government

The UK Government is faced with their own challenges, namely, how to manage all the additional customs import and export declarations in relation to HMRC's CHIEF system, which they say has been "beefed up" but is currently being replaced with their CDS system, with timing far from ideal. Making ports and airports free zones reduces the need for multiple customs declarations to process goods within the zone (i.e., customs warehousing to inward processing and then re-export), provided a manufacturer is permitted to perform those operations under the zone's customs authorization/control, and therefore mitigating the need to utilize HMRC's special procedures.

Benefits for the UK economy

There are also benefits to be gained for the UK economy, depending on how these zones are governed. For example, if the appropriate policies are in place to encourage manufacturing within a physical or predesignated virtually managed "zone" at a business's own site using non-UK raw material, many activities can then take place in the UK, creating jobs.

We believe that the benefits can be reaped with policies and technological solutions that are compliant with the WTO's Agreement on Subsidies and Countervailing Measures.

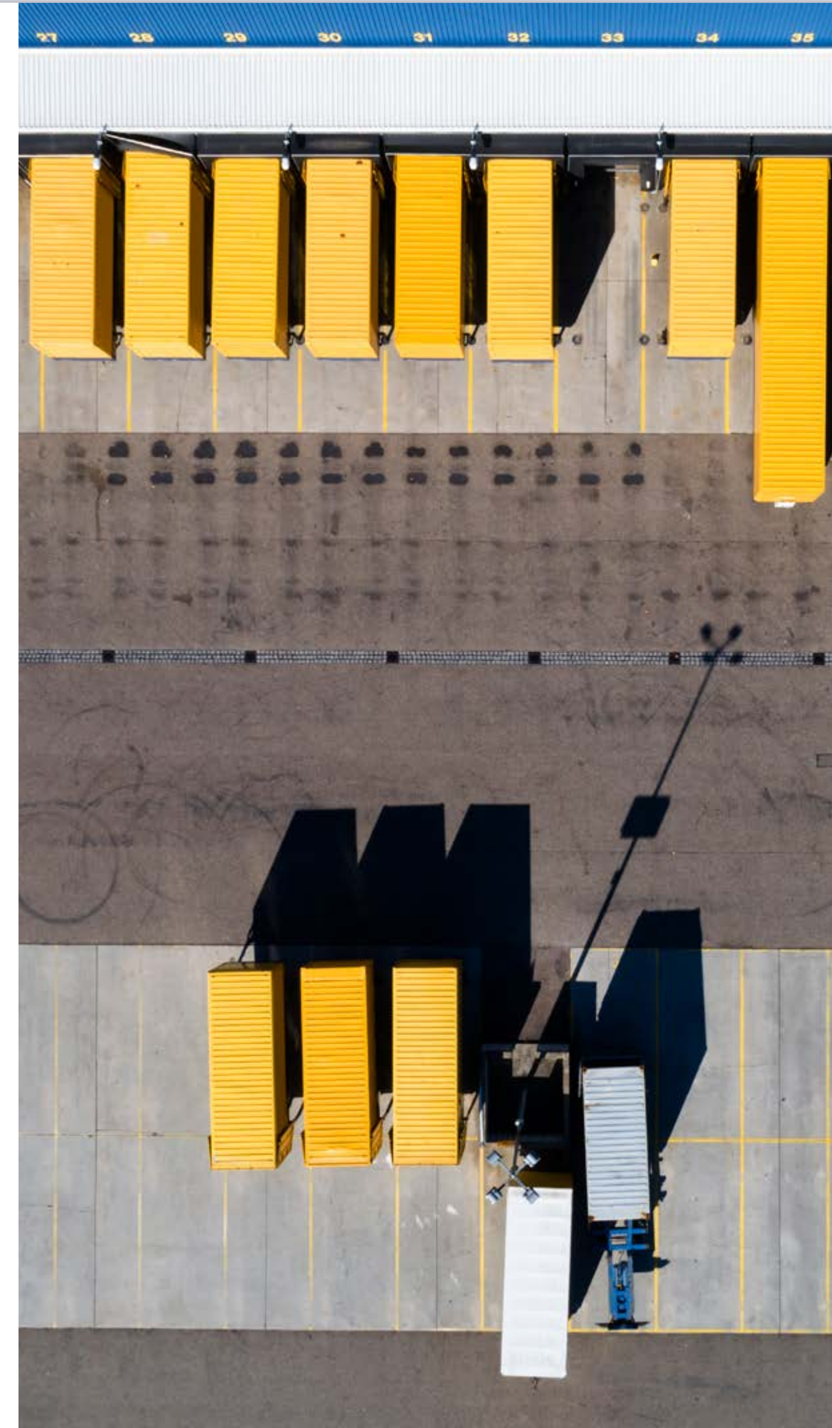
Addressing the counter arguments to introducing post-no-deal Brexit free zones

Diverting existing economic activities

The key argument relates to concerns that economic activities will be diverted from where they are to where the zones would be. This assumes that the zones are limited physically. While redirection cannot be eliminated completely, it can be managed by implementing controls for businesses to operate virtual zones that continue carrying out existing processing activities at their own facilities.

The existing AEO accreditation, or something similar, can help categorize businesses by risk level to determine who is allowed to become part of a virtual free zone. Other government stakeholders can follow the AEO "trusted trader" model for issue of certain certifications currently requiring physical inspection of goods on import and to further stimulate growth of virtual free zones, while further reducing administrative burden.

Provided the right infrastructure exists in the post-no-deal Brexit free zones, new economic activities can be attracted. Furthermore, the cluster effect and economy of scale should not be underestimated, whereby businesses in different parts of the supply chain come together inside a physical area to carry out their manufacturing process.



Incorrect usage

Other arguments look at free ports and consider them to be loopholes for illicit trade and hoarding facilities for high-value goods such as art. Again, this concern is rooted in the fact that focus is on what exists, not what free zones can be. The challenge can be managed by a combination of policy instrument and existing technology solutions.

Instead of policies that benefit storage, there are options to use appropriate policies to encourage more economic activities that will attract labor and offer businesses something less restrictive than the current customs special procedures that were established to facilitate manufacturing processes.

The march to digitalization

The UK Government's digitalization plan

In line with HMRC's (and other government stakeholder digitalization policies), and with the assured knowledge that the technology to make tax/admin fully digital has existed for many years, the strength of our IT (as references in "The technological revolution in effective global trade management") demonstrates we're ready to re-launch a new type of free zone that will not require multiple physical interventions by HMRC.

Using data effectively to manage risks

These free zones will be self-governed by "trusted traders." This also aligns with HMRC's longstanding "promote, prevent, respond" strategy, by utilizing data to drive interventions, while leaving the compliant, self-governing companies alone. Only companies demonstrating the highest standards of customs control/physical security would be considered (i.e., if you can't meet the standards then you can't join the club). Information for customs audit should be accessible to HMRC electronically (and to analyze in real time) to guarantee a robust, traceable audit trail from the free zones. Clearly a "pragmatic" and "open-minded" approach from both HMRC and other stakeholders is required to make this work.

The future of UK legislation on free zones

The UK's primary legislation governing customs matters, Taxation (cross-border trade) Act 2018 would need to be supported by the appropriate secondary legislation to ensure that the overarching digitalization policies can be achieved in the UK post-no-deal Brexit.

Conclusion and next steps

There is so much potential in free zones once the lens used to look at this concept is widened. We firmly believe that the next generation of free zones can be managed and expanded rapidly through using technology that already exists. Should the UK end up leaving the EU without a deal at the end of October this year, or at some later date, businesses and the UK Government should work together to identify opportunities for the UK economy to grow and prosper.

Considering how to use electronic ways to mitigate revenue loss, while keeping customs reliefs that encourage economic activities accessible, is a good start. With free zones that are both physical and virtual, it is possible to harness benefits like never before, while giving the government a better grip on the borders. This concept is both familiar and revolutionary and perhaps a new name should be given to it.

If you believe this initiative is meaningful to your business, you should evaluate your business plan and consider how free zone policies can help your business grow in the UK. Please get in touch with your port operator or the authors of this article to proactively involve yourself in this initiative, before others shape the policies without you. The time to act is now. ■

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Technology

The technological revolution in effective global trade management
60

The technological revolution in effective global trade management

Global trade is changing. This is driven both by external factors — rising geopolitical tensions (US-China trade dispute, Brexit) and increasing risk and compliance requirements (e.g., Criminal Finance Act) — and by internal factors, such as increased supply chain complexity, new trade flows, legacy systems and master data inaccuracies.

Parameters of historically optimal trade flows have evolved, and the impact that technology has in this space cannot be ignored. Data is being collected everywhere, and the amount of information stored by both businesses and governments is growing exponentially.

This means that a race is well underway among organizations to make the best use of data and consequently gain a competitive advantage in the global trade arena. This ranges from using technology to identify opportunities to optimize trade flows and minimize compliance risks to using technology to drive operational efficiencies.

Today, customs managers are overseeing anything from a single entity importing to one country, to global operations. This involves making use of various software and customized tools to assist in managing their customs operations. In recent years, we have seen a significant increase in the use of data analytics and visualization tools to help customs managers understand their business.

For example, descriptive analytics have helped in evaluating the amount of duties paid, from what country and supplier, the ports goods arrive in, VAT/GST paid, Incoterms, invoice currency and more.

Visualization platforms are being built with interactive maps and charts that allow anyone in an organization to dive into what specific good has been moved at a specific time, while also being able to broaden the scope and see trends and quantities of goods moved under various metrics. Businesses are able to quickly identify potential missed free trade opportunities, brokers clearing goods slower than expected, payments in wrong currencies, procurement improvement opportunities and more. As another example, businesses are now able to identify opportunities in classification or potential compliance issues, where the same or similarly described goods are classified in multiple ways through the use of fuzzy matching and word clustering algorithms.

We are also seeing a rise in global trade management (GTM) solutions, such as SAP GTS and Thomson Reuters OneSource, and other options are available depending on each company's needs. These systems are designed to automate or relieve the burden of many aspects of global trade administration,

including direct interfaces to broker or customs authority systems, management of export controls and origin management. Many also include dashboards, incorporating aspects of the analytics solutions described earlier.

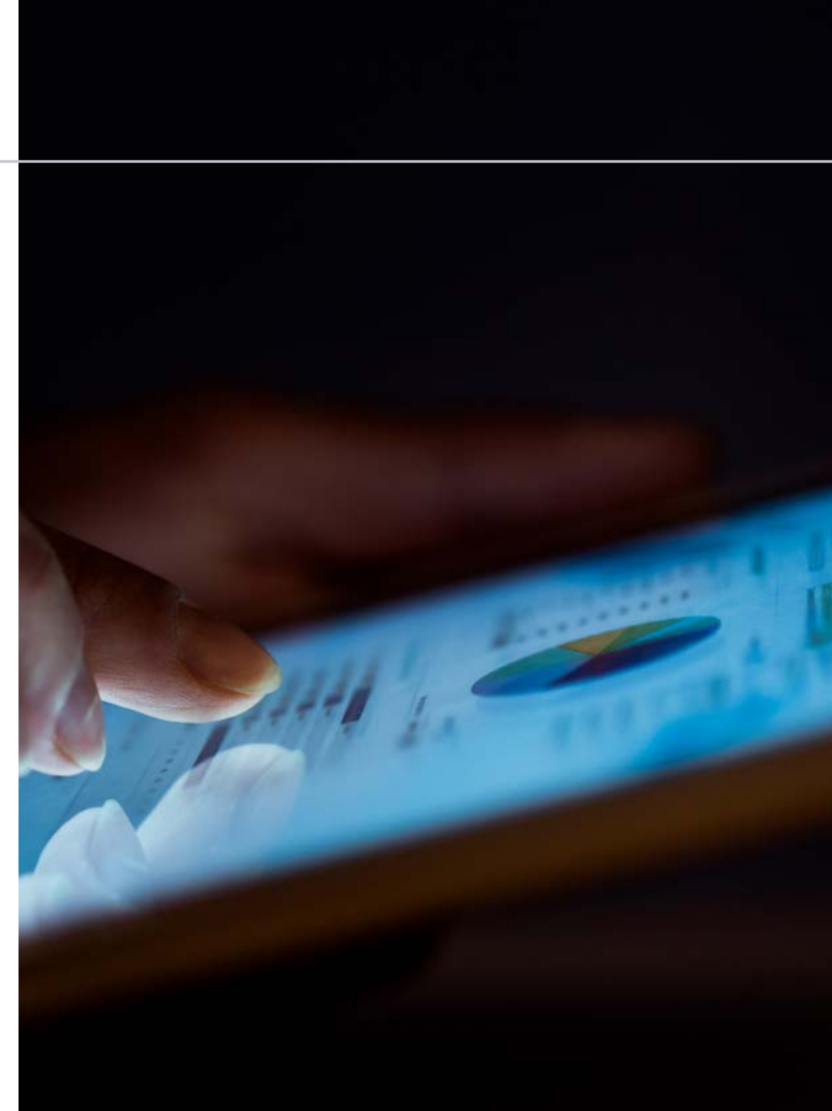
The latest development is a significant rise of machine learning and artificial intelligence solutions. This has been promoted because organizations are no longer limited to their physical IT infrastructure. They can make use of cloud platforms on an on-demand basis that provides them practically unlimited computing power.

The ability of a computer to think and predict like a human has led to the development of various solutions in the areas of customs classification and duty/cost predictions. We are now in a position where algorithms can learn from customs classifications previously made by a business to predict what future classifications will be by the description of the product alone. Within the EY organization, the professionals have developed a highly customizable machine learning solution that allows us to evaluate and choose from a range of algorithms and combine this with data feature engineering techniques such as word clustering or key phrase extraction. This is leading to various opportunities for savings in resourcing, speed of classification and reduced compliance risk going forward.

However, for businesses that lack a robust classification program or are burdened with master data inaccuracies, the risk will now grow significantly, as authorities are investing heavily in their IT capabilities to automatically pick up inconsistencies in customs entries. These machine learning algorithms can also be used by customs authorities to review historical classifications for any business and check not just if a business is consistent in their own classifications, but also against their competitors. This can also be expanded to other aspects of customs, such as valuation, where an authority can review historical customs values with the ability to benchmark against competitors.

Finally, blockchain is also increasing in popularity as a potential solution to various aspects of global trade — such as origin certification. Solutions are mostly at the proof of concept stage, but undoubtedly there is great potential for this technology to be a major player in the coming years.

There are no signs of global trade slowing down in its rising impact on businesses, their operations, people and profits. Supply chains will keep evolving as trade agreements change and production shifts. Meanwhile, borders are becoming "harder" and new borders are being created. There is no doubt that the effective management of global trade operations is becoming more important. To keep up with this pace of change in global trade, the adoption of available technology and implementation of solutions such as those described is essential. Customs authorities will not wait for businesses to catch up, and when combined with the continuous quest of organizations to develop a competitive advantage over their competitors, the implementation and innovation of technology that can save money and improve compliance is going to increase in prominence. ■



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Tax Alerts

Americas

Argentina

- MERCOSUR-EFTA new free trade agreement would eliminate import duties for raw materials and basic products *(09.09.2019)*
- Mercosur-EU new free trade agreement would eliminate import duties for more than 90% of traded products *(13.08.2019)*

Brazil

- MERCOSUR-EFTA new free trade agreement would eliminate import duties for raw materials and basic products *(09.09.2019)*
- Mercosur-EU new free trade agreement would eliminate import duties for more than 90% of traded products *(13.08.2019)*

Canada

- Canada implements new permit and reporting requirements for aluminum and steel imports *(17.09.2019)*
- Canada enhances trade remedy system by amending the Special Import Measures Regulations *(17.09.2019)*
- Canada to remit surtaxes collected on certain imports of heavy steel plate and stainless steel wire *(17.09.2019)*
- Canada-Israel Free Trade Agreement modernization to take effect 1 September 2019 *(29.08.2019)*
- Canada amends the Schedule to the Customs Tariff to correct technical errors affecting tariff items under CPTPP preferential tariff *(29.08.2019)*
- Canada repeals Canada-Costa Rica Free Trade Agreement Non-entitlement to Preference Regulations *(29.08.2019)*
- Canada Border Services Agency updates trade compliance verification list *(15.08.2019)*

Costa Rica

- Costa Rica's General Customs Directorate publishes resolution on guidelines for commercial documents retained by auxiliaries of Customs Civil Service *(01.10.2019)*
- Costa Rica signs new free trade agreements with Korea and the United Kingdom *(16.09.2019)*
- Costa Rica publishes resolution on including royalties and license fees in price actually paid on imports *(05.09.2019)*
- Canada repeals Canada-Costa Rica Free Trade Agreement Non-entitlement to Preference Regulations *(29.08.2019)*

Ecuador

- Ecuadorian Customs Authority issues new regulations on applying for authorized economic operator status *(19.09.2019)*

Global

- International Chamber of Commerce launches Incoterms® 2020: Global Trade, Indirect Tax, Legal, OME and IT consequences *(02.10.2019)*

Paraguay

- MERCOSUR-EFTA new free trade agreement would eliminate import duties for raw materials and basic products *(09.09.2019)*
- Mercosur-EU new free trade agreement would eliminate import duties for more than 90% of traded products *(13.08.2019)*

Uruguay

- MERCOSUR-EFTA new free trade agreement would eliminate import duties for raw materials and basic products *(09.09.2019)*
- Mercosur-EU new free trade agreement would eliminate import duties for more than 90% of traded products *(13.08.2019)*

US

- US Bureau of Industry and Security adds 28 Chinese entities to the Entity List *(10.10.19)*
- WTO rules on US complaint regarding EU civil aircraft subsidies; US announces countermeasure duties on certain EU products and also takes further actions on China origin goods *(03.10.2019)*
- USTR grants new exclusions to Lists 1, 2 and 3 for China origin goods; US and Japan reach agreement on trade in goods and digital trade *(27.09.2019)*
- China publishes first punitive tariff exclusions while US postpones 5% increase to Lists 1, 2 and 3; other regional trade developments *(13.09.2019)*
- US announces additional tariffs in response to China's tariff retaliation for List 4 products and reinstated tariffs on US-origin vehicles and parts *(26.08.2019)*
- US Government expands sanctions against Venezuelan Government *(14.08.2019)*
- US announces details for products subject to 1 September 10% tariffs on imports from China with certain exclusions; provides delay to 15 December for other products *(14.08.2019)*
- US announces 10% tariffs on remaining $300 billion of China origin goods, grants new exclusions on goods subject to 25% duties and reaches agreement with EU for increased beef exports *(06.08.2019)*
- US initiates action against France's Digital Services Tax, issues additional exclusions on China-origin goods and supplements list of products under EU subsidies dispute *(12.07.2019)*

Venezuela

- US Government expands sanctions against Venezuelan Government *(14.08.2019)*

Asia-Pacific and Japan

China

- US Bureau of Industry and Security adds 28 Chinese entities to the Entity List *(10.10.19)*
- WTO rules on US complaint regarding EU civil aircraft subsidies; US announces countermeasure duties on certain EU products and also takes further actions on China origin goods *(03.10.2019)*
- USTR grants new exclusions to Lists 1, 2 and 3 for China origin goods; US and Japan reach agreement on trade in goods and digital trade *(27.09.2019)*
- China publishes first punitive tariff exclusions while US postpones 5% increase to Lists 1, 2 and 3; other regional trade developments *(13.09.2019)*
- US announces additional tariffs in response to China's tariff retaliation for List 4 products and reinstated tariffs on US-origin vehicles and parts *(26.08.2019)*
- US announces details for products subject to 1 September 10% tariffs on imports from China with certain exclusions; provides delay to 15 December for other products *(14.08.2019)*
- US announces 10% tariffs on remaining $300 billion of China origin goods, grants new exclusions on goods subject to 25% duties and reaches agreement with EU for increased beef exports *(06.08.2019)*
- US initiates action against France's Digital Services Tax, issues additional exclusions on China-origin goods and supplements list of products under EU subsidies dispute *(12.07.2019)*

Global

- International Chamber of Commerce launches Incoterms® 2020: Global Trade, Indirect Tax, Legal, OME and IT consequences *(02.10.2019)*

Japan

- USTR grants new exclusions to Lists 1, 2 and 3 for China origin goods; US and Japan reach agreement on trade in goods and digital trade *(27.09.2019)*
- Japan announces stringent licensing procedures for exports to Korea *(29.08.2019)*

Korea

- Japan announces stringent licensing procedures for exports to Korea *(29.08.2019)*

Thailand

- Thailand endorses Thailand Plus Package 7 in response to global trade tensions *(20.09.2019)*

Asia-Pacific and Japan

Tax Alerts

Europe, Middle East, India and Africa

Africa

- African Union launches operational phase of the Africa Continental Free Trade Area *(31.07.2019)*

EU

- WTO rules on US complaint regarding EU civil aircraft subsidies; US announces countermeasure duties on certain EU products and also takes further actions on China origin goods *(03.10.2019)*
- MERCOSUR-EFTA new free trade agreement would eliminate import duties for raw materials and basic products *(09.09.2019)*
- Mercosur-EU new free trade agreement would eliminate import duties for more than 90% of traded products *(13.08.2019)*
- US announces 10% tariffs on remaining $300 billion of China origin goods, grants new exclusions on goods subject to 25% duties and reaches agreement with EU for increased beef exports *(06.08.2019)*
- US initiates action against France's Digital Services Tax, issues additional exclusions on China-origin goods and supplements list of products under EU subsidies dispute *(12.07.2019)*

Global

- International Chamber of Commerce launches Incoterms® 2020: Global Trade, Indirect Tax, Legal, OME and IT consequences *(02.10.2019)*

India

- India's Budget 2019-20 proposes Dispute Resolution Scheme for pending litigation under Excise and Service Tax laws *(17.07.2019)*

Israel

- Canada-Israel Free Trade Agreement modernization to take effect 1 September 2019 *(29.08.2019)*

Turkey

- Turkey amends regulations on post and fast shipping *(07.08.2019)*
- Turkish law including amendments on Income Tax Law, Corporate Tax Law and Customs Law has entered into force *(22.07.2019)*

UAE

- UAE Tax Authority recommends registration of businesses for excise tax before 1 December 2019 *(30.09.2019)*
- UAE announces anticipated expansion of excise tax *(03.09.2019)*

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Global trade disruptors

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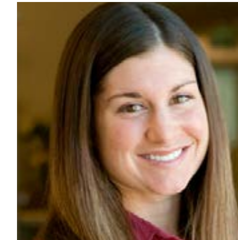

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