

# TradeWatch

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# Spotlight on the European Union

## Significant changes to the Generalised Scheme of Preferences



Effective 1 January 2014, reforms to the EU Generalised Scheme of Preferences (GSP) take effect, which will bring significant changes to the program. Most notably, the number of designated developing countries that benefit from preferential tariffs for exports to the EU will be reduced and new restrictions will be placed on certain products. As a result, a wide range of goods that currently benefit from GSP will lose preferential tariff treatment, and affected importers will face increased import duties unless alternative customs planning opportunities can be identified and implemented.

### Fewer beneficiary countries

Currently, the list of countries included in the EU GSP program contains 176 beneficiary developing countries. Over 20 of these countries, mostly those that no longer qualify as low- or middle-income countries under EU GSP rules, will be excluded from this list and will no longer be eligible for GSP preferential treatment in the EU.

The countries to be excluded from the EU GSP program effective 1 January 2014 include the following:

- ▶ Saudi Arabia
- ▶ Kuwait
- ▶ Bahrain
- ▶ Qatar
- ▶ United Arab Emirates
- ▶ Oman
- ▶ Brunei Darussalam
- ▶ Macau
- ▶ Argentina
- ▶ Brazil
- ▶ Uruguay
- ▶ Venezuela
- ▶ Belarus
- ▶ Russia
- ▶ Kazakhstan
- ▶ Gabon
- ▶ Libya
- ▶ Malaysia
- ▶ Palau

The following countries will also be removed from the EU GSP list as of 22 February 2014:

- ▶ Iran
- ▶ Azerbaijan

### Restrictions for certain products

Some GSP beneficiary countries may already have some developed producing sectors in their country. Such goods produced in these sectors do not require additional support from the EU. The chart below provides an overview of the goods from specific product sectors and specific GSP beneficiary countries that will no longer be eligible for preferential tariffs as of 1 January 2014.

GSP beneficiary country	Ineligible product sectors
China	<ul style="list-style-type: none"> <li>▶ Animals and products thereof</li> <li>▶ Fruits and vegetables</li> <li>▶ Coffee, tea and spices</li> <li>▶ Cereals, flour and nuts</li> <li>▶ Prepared foodstuffs</li> <li>▶ Beverages, spirits and vinegar</li> </ul>
India	<ul style="list-style-type: none"> <li>▶ Mineral products</li> <li>▶ All chemicals</li> <li>▶ Raw hides, skin and leather</li> <li>▶ Vehicles and boats</li> <li>▶ Textiles</li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>▶ Animals and products thereof</li> <li>▶ Chemicals, other than organic and inorganic chemicals</li> <li>▶ Animal or vegetable oils, fats and waxes</li> </ul>
Thailand	<ul style="list-style-type: none"> <li>▶ Prepared foodstuffs</li> <li>▶ Beverages, spirits and vinegar</li> <li>▶ Pearls and precious metals</li> </ul>
Ecuador	<ul style="list-style-type: none"> <li>▶ Vegetable products</li> <li>▶ Preparations of meat and fish</li> </ul>
Ukraine	<ul style="list-style-type: none"> <li>▶ Railway vehicles and products</li> </ul>
Nigeria	<ul style="list-style-type: none"> <li>▶ Raw hides, skins and leather</li> </ul>
Costa Rica	<ul style="list-style-type: none"> <li>▶ Fruits and vegetables</li> </ul>

## Alternative customs planning opportunities

The reform of the GSP in 2014 may cause companies importing into the EU an increase of (non-recoverable) import duties. Other customs planning opportunities may be available in order to mitigate the increased duty costs. Typically, these opportunities have not yet been explored for the specific goods affected by the GSP reform, as these goods have enjoyed long-term duty-free importation, i.e., there never was an incentive to use other customs procedures rather than regular import under certificate of origin until now. We highlight some potential strategies below.

- ▶ **Free trade agreements** – Explore whether the products are covered under an existing or upcoming free trade agreement (FTA) with the EU (e.g., EU-Central America Association Agreement). With four Mercosur countries no longer eligible for GSP (Argentina, Brazil, Uruguay and Venezuela), it will be interesting to see if stalled EU-Mercosur negotiations resume.
- ▶ **Special customs procedures** – Consider “processing under customs control” or “inward processing relief” for imports of raw materials and other inputs to be further processed within the EU.
- ▶ **Customs warehousing** – Explore the use of customs warehouses for goods to be re-exported to countries outside the EU, as such goods may be placed under duty suspension with no duty payable upon export.

- ▶ **Customs valuation and tariff classification strategies** – Conduct a customs valuation review to identify whether certain strategies, such as “First Sale for Export” may reduce the customs value and thus the import duties for the goods. A tariff classification review can also identify opportunities to lower the applied duty rate.

The best alternative planning opportunity to be used will vary from situation to situation; important factors include the nature and the origin of the product, and whether or not it is further processed, re-exported or imported for consumption in the European market.

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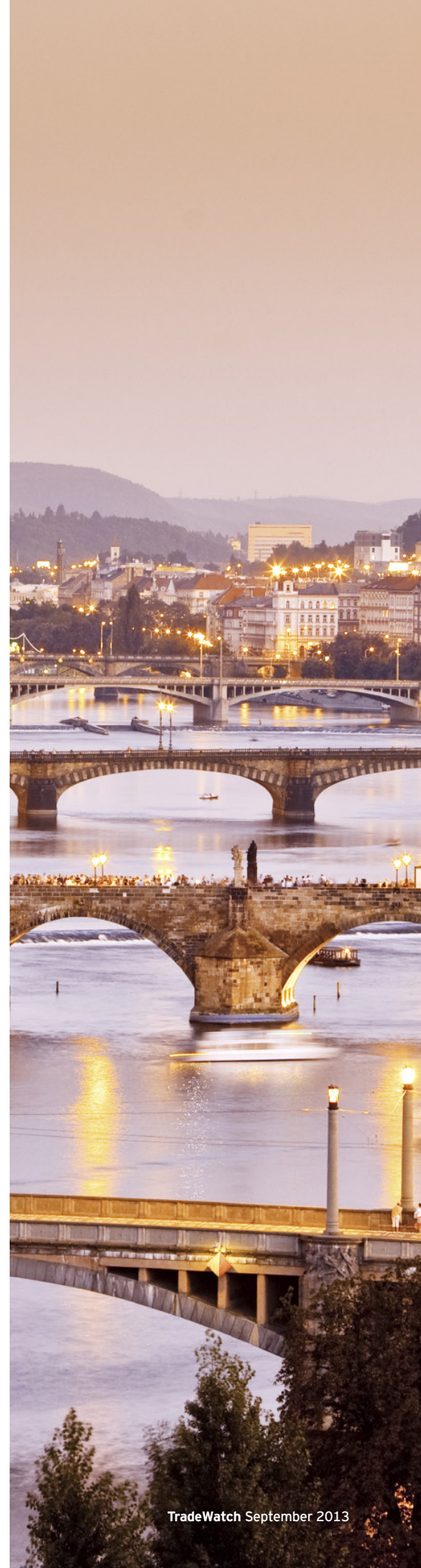
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## EY 2013 Global Transfer Pricing Survey shows significant gap between transfer pricing and customs planning



EY's just-released **2013 Global Transfer Pricing Survey** shows a significant disconnect between the coordination of transfer pricing and customs valuation. The **2013 Global Transfer Pricing Survey** has served as a key industry benchmark chronicling taxpayer views on transfer pricing for nearly 20 years. While this year's report documents an emphasis on prioritizing risk management in transfer pricing, it highlights the struggles of factoring indirect taxes into the transfer pricing equation. The survey shows that only 21% of the respondents indicated that they took customs issues fully into account while developing and planning their transfer pricing policies. The complete EY **2013 Global Transfer Pricing Survey** is available at <http://www.ey.com/GL/en/Services/Tax/2013-Global-Transfer-Pricing-Survey>.

The results of the EY **2013 Global Transfer Pricing Survey** stand in sharp contrast with the experiences reported by a select group of trade executives participating in this year's EY Global Trade Symposium, entitled "Global trade management: how high performers are accelerating ahead." This focused group of high-performing global traders reported 86% collaboration with tax professionals on transfer pricing. Notably, 62% reported that they interact strategically and cooperatively with tax professionals.

Given that 66% of the companies surveyed in the **2013 Global Transfer Pricing Survey** identified risk management as their highest priority (representing a 32% increase over surveys conducted in 2007 and 2010), we expect that cross-functional collaboration between tax and customs will become much more commonplace in the future.

The complete Global Trade Symposium report, containing relevant and useful insights on how high-performing companies confront complicated and sensitive trade matters, will be available at [www.ey.com/customs](http://www.ey.com/customs) soon.

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# Negotiations to expand the Information Technology Agreement suspended



Negotiations to expand the products covered under the World Trade Organization (WTO) Information Technology Agreement (ITA) were abruptly suspended on 17 July 2013. The latest roadblock is China.

As we reported in the December 2012 *TradeWatch*, “Signs of momentum – Information Technology Agreement expansion,” negotiations have been underway to update the ITA in order to include new technologies and multifunction IT products. These additional products would then benefit from duty-free entry into WTO member countries that participate in the expansion agreement.

The latest draft list of ITA expansion products includes 256 items. The participating countries were to review the proposed list and identify any import-sensitive items from their perspective. In this respect, the United States asked that one item be removed from the list. In contrast, China asked that 106 of the 256 items be completely removed from the list to protect domestic manufacturers, a move that has stalled progress and led to negotiators voting to suspend negotiations.

A statement issued by the United States Trade Representative on 17 July said, “We are hopeful that China will carefully consider the concerns it heard this week from many of its negotiating partners, and revise its position in a way that will allow the prompt resumption of the negotiations.” To date, however, China’s position remains unchanged.

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## Brazil

### New supplement to the tariff nomenclature coming soon



Brazil is working to develop a new reporting requirement to the customs declaration that will supplement the tariff classification under the Mercosur Common Nomenclature (NCM). The current proposal to create the new Detalhamento Brasileiro de Nomenclaturas (DBN or Brazilian Detail to the Nomenclature) intends to provide the government with a better tool to create statistical foreign trade information. A technical group was created by CAMEX Resolution #36/2013 to develop and manage the DBN, which will consist of four numeric digits to be declared in a particular field on the customs declaration.

The private sector is requested to submit petitions to create the supplemental DBN code for each of their products pursuant to a form posted on the website ([www.desenvolvimento.gov.br](http://www.desenvolvimento.gov.br)). Each form must refer to a single product and be accompanied by technical catalogs, reports and relevant literature in order to determine the correct classification of the goods. This detail seeks information not only on import/export volumes for the product, but also the volume of production, consumption and sales.

While the DBN will not affect the rate of duty, the statistical data could be useful for importers and exporters to support trade measures (e.g., safeguard investigations), requests for import tariff reduction and investment decisions.

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## REINTEGRA program extended

REINTEGRA (Regime Especial de Reintegração de Valores Tributários para as Empresas Exportadoras) was introduced by Provisional Measure 540/2011 as a special tax refund regime for exporters of manufactured goods. Specifically, the program aims to reintegrate residual tax amounts that exist in supply chains (i.e., taxes paid throughout supply chains that have not been offset).

As reported in the September 2012 issue of *TradeWatch*, exports are not subject to taxes normally due on merchandise sales transactions, such as federal and state value added tax (VAT) (IPI and ICMS, respectively), PIS and COFINS over gross revenue. Nevertheless, these taxes are due on the purchase of inputs used in the manufacturing of exported products. Although most of the taxes are recoverable, tax credit accumulation and cash flow costs resulting from such transactions generate residual cost that exporting companies are not able to offset by the credits system. REINTEGRA benefits exports in this respect by establishing the refund of 3% of this tributary residual cost of exported goods.

Many exporting companies have taken advantage of the REINTEGRA program, which was originally set to expire at the end of December 2012. While Provisional Measure No. 601 had attempted to extend the expiration date to December 2013, the measure was not timely passed by the Brazilian Senate.

Provisional Measure No. 610 was recently published in order to rectify this issue and with its conversion into law (Law 12.844/2013), REINTEGRA has been extended to the end of December 2013.

We note that industry is requesting further extensions of the program to 2017. Due to the upcoming Brazilian Presidential elections in 2014, new developments are not anticipated until the end of 2013, meaning that industry again faces uncertainty with respect to the future of the program.

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# Canada

## The Canadian “iPod Tariff” update



The Canada Border Services Agency (CBSA) scraps “end-use certificate” requirement, but still no “plug-and-play” solution for importers of consumer electronics.

There have been some significant developments since our June 2013 *TradeWatch* article, “The iPod controversy in Canada and end-use certificates,” on this controversial issue.

Rarely does a CBSA Customs Notice (CN) receive as much attention as did CN 13-015, published on 28 June 2013. This CN effectively reversed the CBSA’s position on the “end-user certificate” requirement, the issue at the center of the “iPod tariff” controversy. Although the new approach of removing the requirement is welcome, importers are still faced with significant challenges when applying duty-free treatment under tariff code 9948 for consumer electronics.

The major controversy surrounding the applicability of 9948 to certain consumer electronics stems from the Departmental Policy Memorandum on 9948.<sup>1</sup> In this administrative policy document, the CBSA states that it expects importers to collect and keep records of end-user certificates confirming that consumer electronics imported as 9948 goods are actually being “used in” computers and video game consoles.

For consumer electronics that might otherwise qualify for 9948 duty relief, the typical scenario is one where importers and end-users do not interact directly but through several intermediaries, including distributors, wholesalers and retailers. Clearly, the administrative burden of having to collect end-user certificates from consumers, especially when the importers are several degrees removed in the trade chain from the end-users, would be a serious burden on both importers and intermediaries, like distributors and retailers.

With the issuing of the recent CN, the issue of end-user certificate requirement is gone, and importers no longer need to worry about communicating with end-users and collecting end-user certificates. The requirement for end-user certificates has been scrapped as of 28 June 2013, the date of the CN 13-015 – “Clarification of the Imported Goods Records Regulations.” The clarification to the end-user certificate requirement reads as follows:

*Effective June 28, 2013, for commercial goods imported and released duty free under tariff item 9948.00.00 in the List of Tariff Provisions set out in the schedule to the Customs Tariff, it will be clarified that the CBSA will allow the importer of the goods to attest to the intended use to be made of the goods in an article listed in tariff item 9948.00.00, rather than require a certificate or other such record to be signed by the user of the commercial goods attesting to their actual use.*

It is unclear whether this resulted from lobbying pressures<sup>2</sup> or was simply a consequence of internal reflection on an issue that had received more than enough press.

The remainder of the CN states that this development is merely a “realignment” of CBSA policy under existing Canadian customs law. It is importers who bear the burden of proving that the qualifying consumer electronics do indeed qualify as goods “for use in” computers, video game consoles, etc., within the strict meaning of the legal terms in the Schedule to the Customs Tariff.

<sup>1</sup> CBSA, D10-14-51 – “Tariff Classification Policy: Tariff Item 9948.00.00” (6 September 2007).

<sup>2</sup> See, e.g., Canada News Wire, “Canadian importers and retailers victims of \$16-million tax grab,” 23 May 2013.



Importers bear this burden at the time of importation, where the very declaration of a tariff classification number, such as 9948, requires the importer to make a considered statement that the concerned consumer electronics are 9948-eligible. They continue to bear this burden for up to four years after importation, the legislative period throughout which those importations can become subject of CBSA audits and administrative reviews (and even longer if the importer has applied for refunds by drawback on previously imported products where 9948 was not used). The requirement for a written attestation from the importer is in line with requirements of this duty-free provision.

Under the new policy, importers remain responsible for diversions of goods from intended use. The CN clarifies that, if the importer becomes aware of any diversion of 9948 imports, i.e., if the importer becomes aware that such goods are not being "used in" computers, it is the importer who will be held responsible for reporting the diversion and for remitting additional duties and taxes owing. It is unclear under which circumstances the CBSA will consider this obligation was not met, and it is unclear under which circumstances enforcement action will ensue. Echoing prior concerns with the end-use certificates requirements, the CBSA cannot simply assume that consumer electronics importers have visibility on the sale and end-use of the goods they import.

Although importers will now be able to document the end-use of articles imported under 9948 by attesting to their intended use, this does not amount to "plug-and-play" duty relief for consumer electronics. How will they ascertain the intended use? How will they keep records of this use? Additionally, certain imports of consumer electronics simply do not qualify as "for use in" a computer. For those that might qualify, at first sight, there remain interpretative challenges to determining whether they actually do qualify for 9948 relief. In Canada, in addition to familiarity with the General Rules for Interpretation of the Harmonized System, importers need to become comfortable with the jurisprudence on 9948 relief. Furthermore, importers remain responsible for reporting any known diversions from the end-use to which they are attesting in writing. Something suggests that this controversy has not seen its final appearance. We will keep you informed about any developments.

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# Peru

## Peru ratifies Pacific Alliance Framework Agreement



Peru's Ministry of Foreign Affairs ratified the Pacific Alliance Framework Agreement with the publication of Supreme Decree No. 031-2013-ER in the *Official Gazette* on 11 July 2013.

The Pacific Alliance is a trans-Pacific trade development area established by Peru, Chile, Colombia and Mexico. The agreement was signed on 6 June 2012. Costa Rica was recently accepted as a full member, and a growing number of countries, including Canada and the United States, are participating with observer status.

The Pacific Alliance aims for free trade and economic integration by facilitating the cross-border movement of originating goods, services, capital and people between member countries. The main purpose of this agreement is to establish a deep integration area between the member countries to promote the growth, development and competitiveness of their economies, and to become a political, economic and commercial hub with special emphasis on the Asia-Pacific market.

While the member countries are already partners in FTAs between each other, the Pacific Alliance intends to consolidate the existing FTAs into a single instrument that contains a common tariff reduction schedule, a single set of rules of origin and the establishment of a common electronic certificate of origin, while also expanding origin "cumulation" rules.

Once implemented, 92% of all goods traded between the member countries will enjoy duty-free treatment. A duty liberalization schedule applies to the remaining 8% of goods.

This agreement will become effective within 60 calendar days counted from the date on which the last ratification instrument is deposited. Mexico and Chile have already ratified the agreement, thus implementation is pending ratification in Colombia, where the process is still proceeding.

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## Vietnam

### New advance ruling rules for tariff classification and customs valuation



Effective 1 July 2013, Vietnam has implemented new advance ruling rules for tariff classification and customs valuation. The advance ruling scheme for customs was first introduced in the Amended Law on Tax Administration issued by the National Assembly last year. Previously, Vietnam Customs authorities did not provide any guidance on advance rulings – the written confirmation to determine customs valuation and tariff classification of exports/imports before carrying out customs procedures.

The advance ruling rules for customs offer enterprises more room to actively manage duty payable before the actual importation/exportation. Benefits include reduced compliance costs and the prevention of potential conflicts between customs authorities and enterprises with respect to customs valuation and tariff classification.

The Ministry of Finance recently issued Official Letter 8356/BTC/TCHQ (OL 8356), which provides detailed guidance on procedures and the application dossier for advance rulings in Harmonized Schedule (HS) tariff code classification and dutiable valuation. Pursuant to OL 8356, the application dossiers for advance rulings must be submitted at least 90 days in advance of the import/export declaration of goods specified in the application. The documentation will comprise:

- ▶ Application forms made in accordance with OL 8356
- ▶ Related contracts for the application
- ▶ Technical documents on goods specifications
- ▶ Catalog or sample of goods
- ▶ Vouchers and documents reflective of price quote (for predetermination of customs value)
- ▶ Other documents as requested by Vietnam Customs

Of note, the taxpayer must meet the following conditions if they would like to request advance rulings on customs valuation:

- ▶ Have not imported or exported identical goods
- ▶ Have import/export activities for at least two consecutive years counted to day of filing the application for advance ruling

- ▶ Not be sanctioned with administrative violations on acts of smuggling, illegal transaction and tax fraud in import and export of goods
- ▶ Have performed payment via bank by the letter of credit method for all export/import goods as requested
- ▶ All goods shall be delivered once

As per the last requirement above, the advance valuation ruling will essentially only apply to one shipment, which does limit the practical application for planning purposes.

With respect to the scope, the rules delegate the responsibility to handle and verify the adequacy/completeness of the application dossier to the provincial Customs authorities. Within five working days after receiving the sufficient dossier, the local Customs authorities shall have provided the written proposal to the General Department of Customs (GDC) for consideration. And 25 working days later (90 days for a complicated case), the General Director of GDC will issue written notification on the result of application dossiers (rejection or approval) in case no further clarifications are needed.

The advance rulings will be effective for a maximum period of three years from its issuance date. They will be invalid in case the actual exports/imports or related documents are different from those of the application file when applying for the same.

Customs valuation and tariff classification are primary concerns of MNCs who have export/import activities in Vietnam, especially for those with significant related parties trading volume. The introduction of advance rulings should be a welcome advancement for importers, enhancing the certainty of customs operations.

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# Europe, Middle East and Africa

## Germany

### German Foreign Trade and Payments Act undergoes modernization



The German Foreign Trade and Payments Act (Außenwirtschaftsgesetz) is a compilation of provisions covering a variety of areas. Most important and relevant for the majority of companies are possibly the national export control prohibitions and the notification requirements in respect to capital movement and payments. The act was enacted in 1961 to replace occupation law in the western part of Germany and for the first time stipulate the basic principle of open traffic in goods. During the past 50 years, the act has undergone dozens of changes, leading to an expanded conglomeration written in a language that is outdated from today's perspective.

A modernization of the act has now successfully passed the legislative bodies and took effect 1 September 2013. Besides "modernization of the language," one of the goals was to make the Foreign Trade and Payments Act more transparent, especially for small and medium-size companies (SMEs) that do not have their own legal department, by restructuring and shrinking the amount of paragraphs from over 50 to 28. However, the reduction is a bit of eyewash, as some "deleted" provisions have been transferred to the Implementing Regulations.

#### Changes affecting export controls

There are no material changes to the currently existing export control principles. Unlike recent changes in the United States, the provisions addressing export of munitions and dual use goods have not been simplified. As in the past, the approval of export licenses for export controlled goods is dependent on the implications for foreign relations, security policy and human rights aspects (this abstract criteria offers some "legroom" for the cabinet – depending on the governing party – and its ideals about these protected values). Hence, from a material law perspective, the covered areas of the Foreign Trade and Payments Act will not experience a significant reduction of regulation nor will the provisions become less strict.

Yet, there will be some minor changes, such as simplifying export licensing requirements (e.g., export licensing requirement in case of indication of military use of non-listed goods to Cuba, increase of various *de minimis* thresholds where an export license shall no longer be required). Other specifically German restrictions, however, remain the same without any adaption to EU or international common standards (e.g., export licensing requirement in case of indication of use of export goods for nuclear purposes in nine designated countries).

#### More restrictive approach to penalties

An important area of change addresses penalties. There will be a much more restrictive approach with respect to penalties. Given Germany's strength in technology, illegal exports of export controlled techniques and machinery has regularly been an issue in the past years. Sanctioned countries with a lot of creativity aim to purchase or get their hands on high-tech goods especially for their nuclear programs. Even with the legal changes, the prosecution of a deliberate, intentional export of restricted items without a valid export license will in any case be treated as a crime with a possible sentence of up to five years of prison time or monetary penalties. The deliberate infringement of munitions embargoes is now sentenced with up to 10 years of prison time instead of up to 5 years. A significant change is also that intentional infringement of export control regulations will now – in any case – be treated as a crime. Further changes address specific situations of non-compliance.



## New voluntary disclosure provisions

In the final discussions of the Parliamentary Committee, a most welcome novelty has been introduced: the voluntary disclosure. According to the Foreign Trade and Payments provisions, it will be possible as of 1 September 2013 to make disclosures in order to avoid punishment. Such a disclosure requires – among others – that the following requirements are met:

- ▶ The legal consequence deriving from the irregularity will be treated as an event subject to an administrative fine.
- ▶ The underlying irregularity is only minor or has been done negligently.
- ▶ The irregularity has been identified during the self-monitoring processes.
- ▶ Appropriate measures have been taken to avoid repeating the same mistake.
- ▶ The issue is disclosed to the competent authority.

Of course, a valid disclosure is possible only as long as the competent authorities have not yet started their own investigations. Practically, the opportunity of such a disclosure will allow companies (and natural persons) to remedy basic operational and formal mistakes. In most cases, this type of disclosure will likely involve errors in notifications or information requirements, document retention, disclosure obligations or issues in relation to the presentation of goods designated for export, etc.

It is also important to mention that an effective disclosure will only avoid administrative fines under the Foreign Trade and Payments Act. Independently, the authorities will still be entitled to assess sanctions based on fine provisions pursuant to other legal acts (e.g., fines for lacks in organization and supervision) or impose indirect sanctions (e.g., increased tax supervision, customs audit, restriction or withdrawal of customs authorizations). This may, however, not be in line with the basic concept of allowing an effective disclosure.

This disclosure will naturally not be available for intentional actions or actions undertaken with knowing disregard. This will be treated as a crime. A proactive disclosure also in the latter cases will (normally) lead to a reduction or even waiver of penalties, but it would not have the legally binding effect as the relieving disclosure.

Yet, it should also be said that some questions about the legal interpretation of the new rules addressing specific situations are unclear and will most likely require court rulings in order to have more clarity. Hence, companies need to critically examine the facts and analyze the legal situation to identify unclear questions and avoid an unexpected outcome.

Furthermore, when preparing letters of disclosure under the new law, the facts and circumstances will have to be extensively analyzed to determine whether an irregularity happened solely negligently, grossly negligent, intentionally or with knowing disregard to determine whether the possibility for a relieving disclosure is available. In this respect, it should be a high-priority goal to reduce the risk of non-compliance.

Many companies that have issued compliance rules (in a Code of Conduct and/or more specific directives for export control, customs, tax or any other area) often determine that the company and its personnel shall be in compliance with the applicable external and internal environment of regulations and directives. Normally, that is done by simply forbidding unlawful action respectively formulating the ideal of compliant behavior. Practically, if the prohibition statement is the sole instruction, in our experience, there is an increased likelihood that the goal will not be achieved because in some cases individuals will ignore compliance risks to make a sale.



Besides conflicting personal motivation (e.g., getting a bonus, reaching sales figures to keep the job) most often people simply lack knowledge of personal risks (often, people think fine and penalty procedures would address only the company or upper ranks of directors or managers). Whereas it is almost natural to accept a certain exposure of risk in order to do business, especially with respect to export controls, the borderline of (non-) acceptable risk is crossed easily.

Therefore, as an important component in a company's compliance organization, teaching the relevant employees the fine differentiation of the above legal terms and the legal consequences in case of infringements is a good idea. At its best, case studies built on the company's daily business operations are used to show and raise real understanding of critical situations and explain connected sanctions at stake for the company, management, corporate function and acting operational personnel to achieve support to be and stay compliant.

For multinational groups of companies having their strategic decision makers and stakeholders outside of Germany, it is often a challenge for the local companies to adopt measures consistent with the national compliance program, which, to repeat the message, significantly help to gain support for the compliance program. In this respect, the same applies with respect to dealing with tax and customs generally, as almost the same legal definitions apply for the determination of the applicable criminal law or administrative fine provisions in case of irregularities connected to the underpayment of taxes or import duties. With the adoption of prior disclosure rules, which can be very beneficial to qualifying business, there will be increased importance on clearly defining and training the export compliance policies.

## Changes addressing capital movement and payment notifications

Finally, with the modernization of the Foreign Trade and Payments Act, changes relating to obligations addressing the capital movement and payment notifications entered into force on 1 September 2013. Most importantly, all different types of notifications must now be stored electronically, either through an official web portal (designed especially for SMEs) or IT solutions for reporting (typically used by big companies), which can be integrated into their ERP and are available from various software providers or may also be self-programmed. Furthermore, the so-called "Z1 report" will not be required any more for German residing parties that provide money to foreign persons via banks residing in Germany. Some other reports will require the more detailed provision of data, whereas in others, few data elements will be deleted. Companies established in Germany being required to file the capital movement and payment notifications should familiarize themselves with the new reporting formats to ensure compliant provision of the statistical data to the Federal Bank.

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# Russia

## Russia lowers tariff rates



Last month marked the first anniversary of Russia's accession to the World Trade Organization (WTO). Pursuant to its WTO accession commitments, Russia has lowered tariff rates on a variety of imported goods, including a wide range of agricultural products, alcohol and certain footwear.

The new rates of import duties are established under a number of recent decisions – including Decision No. 138 (effective 26 July 2013) and Decision No. 139 (effective 1 September 2013), adopted by the Board of the Eurasian Economic Commission to amend the Unified Customs Tariff of the Customs Union, which includes Russia, Belarus and Kazakhstan.

This package of amendments is the first to be adopted by Russia in fulfillment of its WTO commitments. It should be emphasized that under the Agreement on the Functioning of the Customs Union in a Multilateral Trade System, the commitments that Russia assumed when it acceded to the WTO become part of the legal system of the Customs Union and apply to goods imported into all Customs Union member countries.

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# Ukraine

## New transfer pricing law – implications for importers



On 4 July 2013, Ukraine's Parliament passed the Transfer Pricing Law, which became effective on 1 September 2013. This law applies primarily for corporate income tax and VAT purposes. However, the new transfer pricing law will also impact customs matters – primarily with respect to customs valuation for cross-border sales involving related party transactions. Accordingly, new challenges could arise for importers now that the law has taken force.

Under the law, the purchase of goods from a related entity (including a non-resident) where the aggregate value of transactions for the year with the entity equals or exceeds UAH50 million (approximately US\$6.25 million) will now be among those transactions that are controlled for transfer pricing purposes. The law establishes valuation methods that are compatible with the OECD Transfer Pricing Guidelines.

At the same time, imported goods remain subject to valuation based on methods established by Ukraine's Customs Code and based on the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (i.e., WTO Valuation Agreement). Customs value serves as the basis for collection of customs duty and VAT. This, of course, brings to the Ukraine the tension experienced in other countries that follow the OECD approach to transfer pricing: two sets of rules applicable to the same transaction. In common with other jurisdictions, the rules are not harmonized.

### Enforcement expected to increase

We expect both the tax and customs authorities to start applying the arm's-length principle based on their own set of rules more vigorously. The conflict between the two valuation methods may trigger adverse tax implications for the importer. Ukraine's tax and customs offices recently merged, but the two sides are unlikely to follow a common approach in the near future.

### Special concerns for importers

Importers will want to particularly focus on these aspects of the new law:

- ▶ The law introduces a requirement that transfer pricing documentation be filed with the tax authorities. That documentation is not on the list of mandatory documents to be submitted to customs during customs clearance of the goods. However, we expect that these documents will be requested when customs authorities verify the declared customs value, particularly in the event of a post-importation audit. Taxpayers are well advised to prepare transfer pricing documentation taking into account customs valuation issues in preparation for this review by the customs authorities.
- ▶ The tax authorities are allowed to carry out transfer pricing audits. The law explicitly prohibits verifying issues other than transfer pricing during such audits. While customs valuation would not be verified during a transfer pricing audit (and vice versa), taxpayers should expect that a transfer pricing audit could trigger a customs audit (and vice versa), particularly considering that the customs and tax offices have merged.
- ▶ The law allows taxpayers to adjust transfer prices (upward) provided that this does not decrease the assessed taxes. It appears that the taxpayer is not allowed to increase transfer prices if this reduces the already assessed taxes. At the same time, it is unlikely that a taxpayer would be able to adjust downward the customs value in respect of imported goods if the tax authorities establish the "arm's-length price" at a lower level. Although the law envisages a pro rata adjustment (i.e., by the seller and the buyer of goods simultaneously), the adjustment procedure for cross-border transactions is not clear.



- ▶ Large taxpayers may seek an advance pricing agreement (APA) on transfer prices with the tax authorities in advance. Large taxpayers include entities whose aggregate income for the past four consecutive months exceed UAH500 million (US\$62.5 million) or whose total taxes paid for that period exceeds UAH12 million (US\$1.5 million). It is unclear whether the customs authorities would accept the declared customs value if it is in line with the advance pricing agreement. Unless the customs authorities explicitly confirm this, we recommend seeking an advance customs ruling in conjunction with an APA.
- ▶ For certain imported goods (including oil, gas, metal and grain), the taxpayer may define the transfer price as the commodity exchange price/published price reduced by 5% (for sale transactions) or increased by 5% (for purchase transactions). It is not totally clear whether such prices would be accepted for customs purposes and an advance customs ruling may be required.

## Immediate impact

Companies should be ready to report their controlled transactions in 2014 (for September through December 2013); valuation conflicts may thus arise soon after the transfer pricing audit. Therefore, it is recommended that taxpayers incorporate into the transfer pricing studies those elements additionally needed by customs administrations to determine acceptable customs valuation. Due preparation of a transfer pricing study with regard to customs valuation issues may mitigate the risks and smooth the audit process.

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# East African Community

## Export Processing Zones – a key investor incentive in East Africa



We are seeing increased interest in Export Processing Zones (EPZs) by multinational companies looking to invest in East Africa. For instance, a US company is looking to invest in manufacturing operations in Kenya to supply the East African Community and the African market in general. The company sources its major raw materials in Kenya and other secondary raw materials from Asia. This and similar scenarios could benefit from the incentives under the EPZ regime for approved exporters.

### What is an EPZ?

An EPZ is a customs area where the company is allowed to import plant, machinery, equipment and material for the manufacture of goods to be exported under guarantee, without the payment of duty. The imported goods are subject to customs control at importation, throughout the manufacturing process, to the time of sale/export, or duty payment for home consumption.

Within the East African Community (Kenya, Uganda, Rwanda, Tanzania and Burundi), EPZs are currently operational in Kenya and Tanzania. Uganda is in the process of setting up EPZs within a planned industrial business park currently under construction. Rwanda is instead using Special Economic Zones (which is a more legally structured approach with bilateral economic laws and infrastructure and includes EPZs) to attract investors.

EPZs in Kenya and Tanzania are licensed by an autonomous body, the Export Processing Zones Authority, and are regulated and administered under the Export Processing Zones Acts.

It is important to note that pursuant to the Protocol for the Establishment of the East African Community Customs Union (2004), any export-related incentive (i.e., EPZ) is accessible only to operations that export 80% of production to countries outside of the East African Community. Although 20% of the EPZ's production can be supplied within the region, such goods are subject to import duties at the common external tariff rates. While this requirement has not been enforced in the past, Kenya is now starting to penalize companies that do not comply. Accordingly, this is an important business and cost consideration for companies looking to establish an EPZ that will have some sales within the East African Community.

### Requirements for obtaining an EPZ license

In order to obtain any EPZ license in Kenya or Tanzania some of the following requirements should be met:

- ▶ The company is incorporated in Kenya or Tanzania for the sole purpose of developing and operating an EPZ or producing goods or services within an EPZ.
- ▶ The company has the necessary capital and expertise required for developing the EPZ.
- ▶ Except for an EPZ operator, the company owns or leases land for a minimum period of 30 years within the EPZ.
- ▶ The company is engaging in eligible activities to be undertaken by an EPZ enterprise in the EPZ.
- ▶ The company shall not have a deleterious impact on the environment or engage in unlawful activities, impinging on national security or may prove to be a health hazard.
- ▶ The company shall conduct business in accordance with the law.

## Activities undertaken in an EPZ

The following activities are permitted in an EPZ and any applications for licenses should be for one or more of the activities:

- ▶ Commercial activities – trading in, breaking bulk, grading, repacking or relabeling of goods and industrial raw materials
- ▶ Manufacturing activities – conversion of organic or inorganic material by manual, mechanical, chemical or biochemical means into a new product by changing the size, shape, composition, nature or quality of such material; and assembly of parts into pieces of machinery or other products
- ▶ Services activities – an export-related service provided by an EPZ enterprise including consultancy, information, brokerage and repair services, but excluding financial services and commercial activity

Different licenses/permits are issued for the above activities. A license can be issued to an investor as an EPZ developer, an EPZ operator or an EPZ enterprise. The developer license is issued to those entities that develop and administer the EPZs, the operator license is issued to those who manage the EPZs and an enterprise license is given to those who deal in any activities within the EPZ, including a developer or operator.

## Benefits of operating an EPZ

EPZ license holders will enjoy the following benefits:

- ▶ Exemption from registration under the Value Added Tax Act
- ▶ Exemption from the payment of excise duties
- ▶ Exemption from the payment of income tax for the first 10 years from the date of first sale as an EPZ enterprise, except that the income tax rate shall be limited to 25% for the 10 years following the expiry of the exemption (provided that this exemption shall not apply in respect of commercial activities of an EPZ enterprise not directly related to its manufacturing activities)
- ▶ Exemption from the payment of withholding tax on dividends and other payments made to non-residents during the period that the EPZ enterprise is exempted from payment of income tax
- ▶ Exemption from stamp duty on the execution of any instruments relating to the business activities of an EPZ enterprise





- ▶ Exemption from quotas or other restrictions or prohibitions on import or export trade with the exception of trade in firearms, military equipment or other illegal goods
- ▶ Exemption from exchange controls on payments for:
  - Receipts of export processing exports
  - Payments for raw materials; intermediate goods; tools and spares; supplies; construction equipment and construction materials; capital equipment; office equipment; repatriation of royalties; management fees; technology transfer fees; profits; dividends; advertising expenses; inspection fees for quality control; debt service; and any other legitimate business expenses
  - Capital transactions, except on capital funds raised from Kenya residents subject to exchange control in which case remittance of dividends, profits, debt service and any other returns to such capital invested shall be subject to the Exchange Control Act
- ▶ Exemptions from rent or tenancy controls
- ▶ Any other exemptions as may be granted by the Minister by notice in the *Gazette*

## Conclusion

High tax rates, perceived poor tax systems and the burden of tax administration are some of the key disincentives to investors into Africa in general. Governments within the region have set up mechanisms to support those investors that fulfill the requirements for an EPZ. Applying for the EPZ or even the Special Economic Zones incentive can therefore be a great incentive for investors in the East African region.

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# South Africa

## Implementation of new Customs systems modernization program



In a media statement released on 22 August 2013, the Minister of Finance announced the implementation of South Africa's new Customs management system. As part of an overall modernization program, the new Customs system consolidates and replaces multiple older, paper-based systems into an electronic-based centralized system. Now, the clearing of all import and export declarations are conducted through a single processing engine.

Most importantly, the implementation has been hailed a success, indicating that the import and export declaration processing should go smoothly going forward without disruption. In turn, the promises of a more expedient and cost-effective Customs processing are coming to realization. According to the press release, the Customs management system offers the following benefits to business:

Parameter	Before	After
Paper	16 million pieces of paper used in end-to-end declaration processing	Approximately 800,000 pieces of paper used, mainly for manifest processing
Inspection processing	Between four and eight hours to process a physical inspection	Physical inspections completed on average within two hours
Supporting document process	Supporting documents were better to Customs offices and handed in for processing, which could take hours	Electronic submission of supporting documents is instantaneous, from the desk of the trader to the desk of the Customs officer

While South African traders have been preparing their systems and procedures for the implementation of electronic declaration processing, another essential aspect has been improving internal controls and procedures to promote more accurate and timely declarations. This is now more important than ever. With a centralized, electronic system, the Customs authorities are in a much better position to target risky shipments and identify non-compliance. High-risk traders will receive additional scrutiny from SARS while low-risk traders will receive less. South Africa's trusted trader program is one way for businesses to proactively manage their customs function. Additionally, the availability of electronic data provides businesses with a "big picture" view of their trade operations to not only identify compliance gaps, but also planning opportunities. Importers and exporters should be looking at complementing these electronic systems by implementing internal electronic processes for compliance.

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*TradeWatch* is a quarterly newsletter prepared by EY's CIT group. For additional information, please contact your local CIT professional.

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