TradeWatch

Volume 17, Issue 3

September 2018

EY Global Trade

Quarterly update

EY

Building a better working world

In this issue

NAFTA update: US and Mexico reach an agreement in principle; inclusion of Canada remains uncertain

The North American Free Trade Agreement (NAFTA), which entered into force on 1 January 1994, created one of the world's largest free trade areas. Under NAFTA, import duties on all covered goods traded within the United States (US), Canada and Mexico were gradually phased out and, as scheduled, on 1 January 2008, all remaining duties and most quantitative restrictions on imports were eliminated.

While heavily relied on by businesses to integrate the North American economy, NAFTA has become a focal point of President Trump's efforts to establish a trade policy that promotes America's security and prosperity by, among other initiatives, strengthening the US economy, negotiating new and renegotiating or withdrawing from other trade agreements, and enforcing US trade laws and US rights under existing trade agreements.[1] For example, President Trump during the 2016 presidential campaign stated that he would end US participation in the Trans-Pacific Partnership as it was viewed as "... another massive international agreement that ties us up and binds us down."

A key tenet of the Trump Administration's Trade Policy Agenda is the successful renegotiation of the terms of NAFTA "to get a better deal for American workers and to improve the U.S. trade balance" by updating NAFTA with "modern provisions representing a 21st-century, high-standard agreement and to rebalance NAFTA for fair, reciprocal trade."

On 27 August 2018, after more than a year and seven NAFTA renegotiation rounds, Mexico and the US announced a "preliminary agreement in principle." The agreement is not final; but rather, it is subject to finalization and implementation that replaces the 24-year-old original trade deal.[2] Canada has now officially rejoined the US and Mexico negotiators to potentially join and maintain a trilateral agreement, but ultimate outcome remains uncertain.

The agreement reached between the US and Mexico does provide a path forward for modernizing NAFTA, but as the negotiations were between the US and Mexico, many of the agreed-upon points are specific to those two countries' interests. While final text has not been made available,[3] statements released by both governments, as well as

1 Source available at: https://ustr.gov/sites/default/files/files/Press/Reports/2018/AR/2018%20Annual%20Report%20I.pdf.

2 See United States Trade Representative (USTR) Press Releases, 27 August 2018, "Strengthening NAFTA for Agriculture," "Modernizing NAFTA to be a 21st Century Trade Agreement" and "Rebalancing NAFTA to Support Manufacturing." Available at: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018.

3 The final text is expected to be released no later than 30 September 2018.

unofficial notes that have been circulated, provide further details of the agreement and include, among others, the following key provisions:

Rules of origin

- Increasing the regional value content (RVC) threshold for automobiles from 62.5% to 75.0%:
  - The RVC percentage will vary according to the type of vehicle or parts.[4]
  - Tariff shift (where applicable) will remain; however, the tracing list will be eliminated.[5]
  - A three- to five-year phase-in period is being considered for the application of the new rules of origin requirements.
- Adding a new labor value content rule requiring 40% to 45% of auto content to be produced by workers earning at least USD16 per hour, with research and development and information technology wages counting for 15%[6]
- Requiring finished vehicle producers to purchase 70% North American steel and aluminum[7]
- Strengthening rules of origin for chemicals, steel-intensive products, glass, optical fiber and textiles:
  - New textile rules requiring a greater use of made-in-the-USA fibers, yarns and fabrics by limiting the use of non-NAFTA inputs in textile and apparel trade and requiring that sewing thread, pocketing fabric, narrow elastic bands and coated fabric, when incorporated in apparel and other finished products, be made in the region for those finished products to qualify for trade benefits

Enforcement

- Establishing procedures that streamline certification and verification of rules of origin

Market access (exceeding standards established in NAFTA 1.0 and previously proposed under the Trans-Pacific Partnership)

- Maintains duty-free treatment for originating goods, prohibition on export duties and other charges, as well as waiver of customs processing fees
- Adds transparency to import and export licensing procedures
- Strengthening e-commerce retailing by raising Mexico's de minimis value level from USD50 to USD100, whereby customs entries at or below the de minimis threshold would be exempt from customs duties and taxes and subject to minimal entry procedures

Intellectual property

- Enforcement of intellectual property rights at the border
- Enhanced protection for copyright, trademarks and patents, including in pharma and agriculture
- Increasing data protection for biologic drugs to 10 years and expanding the scope of products eligible for such protection

---

4 For example, while light vehicles would require 75% RVC, heavy vehicles would require 70%. The RVC for auto parts, on the other hand, would range from 65% to 75%, depending on whether these are considered "core," "principal" or "complimentary."

5 For origin qualification purposes, the tracing provision allows certain components to be deemed originating notwithstanding their country of origin.

6 While the specific calculation of the labor value content is yet to be defined, it is expected that it may consider manufacturing costs, technology and assembly expenditures.

7 Seventy percent of an original equipment manufacturer's (OEM's) annual purchases of aluminum and steel would have to be from the US or Mexico (and potentially Canada if a trilateral deal is agreed).

Digital trade

- Prohibits customs duties and other discriminatory measures from being applied to digital products distributed electronically, such as software, music, etc.
- Facilitates digital transactions by ensuring that suppliers are not restricted in their use of electronic authentication or electronic signatures

Agriculture

- Tariffs on agricultural products will remain zero rated.
- Enhanced standards will be in effect for both geographical indicators and sanitary/phytosanitary measures, including the establishment of consultation mechanisms to resolve issues between the two nations.

Evergreen clause

- The agreement remains in effect for 16 years and will be reviewed every 6 years. If agreed after the first review, the arrangement will be extended for another 16 years.[8]

Section 232 tariffs

- Tariffs imposed on Mexico and Canada steel and aluminum exports to the US will remain in effect.[9]
- An import cap on Mexican originating passenger vehicles and vehicle parts is being proposed in case the US imposes tariffs on these types of goods under Section 232.[10]

What's next?

While President Trump has previously stated a preference for reaching separate bilateral deals with Mexico and Canada in lieu of maintaining NAFTA, both Mexico and Canada have consistently continued to push for a trilateral agreement.[11] Following the announcement between the US and Mexico, Canada was asked to negotiate on an urgent basis on a trilateral or bilateral basis. As the issues are not with Mexico, it really amounts to the same thing for Canada. The primary issues are Canada's supply management tariff rate quotas (with high ad valorem tariffs over certain quota levels), with dairy being the focus, the Chapter 19 trade dispute resolution mechanism, and cultural safeguard protections.

The Trump Administration notified Congress on 31 August 2018 and started the 90-day process for a trilateral NAFTA or a bilateral US-Mexico trade deal.[12] If a trilateral agreement is not reached and no subsequent bilateral agreement is reached between the US and Canada, the Canada-US Free Trade Agreement (CUSFTA), which applied previously on a bilateral basis between the US and Canada and was suspended under NAFTA, will apply until terminated. Preferential trade between Canada and Mexico could presumably continue under NAFTA or even under the CPTPP[13] if the US withdraws from NAFTA on six months' notice. Such action would presumably take place after bilateral agreement(s) are signed.[14]

[8] The US dropped its initial "sunset clause" proposal whereby the agreement would be automatically terminated after five years if an extension was not agreed upon by the parties.

[9] Mexico and Canada also applied retaliatory measures to specific US products that will likely remain while the US tariffs are in place.

[10] Such caps are expected to considerably exceed the current import amounts. However, Mexican originating goods exceeding the cap would likely be subject to the Section 232 tariff (likely 25%), plus the most favored nation (MFN) rate (2.5%).

[11] Later statements by USTR Robert Lighthizer signaled the USTR's preference to pursue a revised NAFTA trilateral agreement rather than separate bilateral deals with Mexico and Canada.

[12] Under the trade promotion authority (TPA), the administration must first give Congress 90 days' notice of its intent to sign an agreement, and 60 days before signing, the countries would have to release the legal text of the agreement. Once the implementing bill is introduced, lawmakers have a maximum of 90 days in session to enact it.

[13] The Comprehensive and Progressive Agreement for Trans-Pacific Partnership is a new free trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam that has been signed but not yet entered into force.

[14] Article 2205 of NAFTA provides that any party can withdraw from the agreement on six months' written notice. If withdrawal were to occur, the president would presumably have to seek congressional approval to legislate to repeal existing provisions of law that were legislated as a result of NAFTA.

From a Mexican perspective, the approval process for either NAFTA or a bilateral US-Mexico trade deal must be submitted to the Senate and for revision by the Foreign Relations Ordinary Commission to be voted and ratified. Two-thirds majority of the Mexican Senate must vote in favor of the agreement to be ratified (the Mexican Senate is composed of 128 senators).

In Canada, NAFTA or any other trade agreement is implemented after a full review by Parliament pursuant to parliamentary subcommittees' reports and debate, to be then put to a vote in the House of Commons and Senate. Such process would take several months and then be implemented (in Canada, under constitutional law, treaties or international agreements are not directly applicable) by drafting and passing specific legislation where required (much of this would already be in existence under NAFTA or CUSFTA).

While the changes announced in the preliminary agreement are not immediately applicable, as stated above, certain legislative requirements need to be satisfied prior to implementation of the agreement. Companies operating in the region should be prepared for the impact of proposed changes on their businesses. For those in the automotive, textile and other industries, changes announced to the existing rules of origin will make qualification for benefits under the agreement more difficult. On the other hand, e-commerce retailers and consumers, as well as intellectual property rights holders, such as drug manufacturers, among others, likely stand to benefit under the new terms of the preliminary agreement.

Preparing for change

Companies should evaluate their current NAFTA footprint in order to quantify benefits under the existing agreement. By leveraging their customs data, companies can determine whether they are adversely impacted by the proposed changes to NAFTA or any bilateral successor agreement that may ultimately be reached. Specifically, companies should understand how their products satisfy existing RVC requirements and then explore potential changes or alternatives to sourcing that may be required to preserve originating status under the terms of the preliminary agreement. Also, with regard to those products subject to an increase of RVC, changes to the applicability of qualification by tariff shift, and, for the auto industry, the elimination of the tracing requirement, a closer look on origin qualification options and special methodologies is merited. For example, the use of the self-produced (intermediate) materials rules to aid NAFTA qualification has been quite effective in other industries that have been subject to similar rules previously. These strategies may similarly benefit businesses facing changes under the rules agreed to by the US and Mexico.

Key actions

Companies should take a strategic and proactive approach to deal with the potential changes emerging from the NAFTA renegotiations. The following key actions should be considered:

- Assemble relevant data from Canada, Mexico and the US
- Identify the company's most significant products manufactured in North America, considering:
  - Customs data — to determine categories, amounts and highest duty savings
  - Sales data — to determine highest volumes, values and sales forecasts
  - Products that don't currently qualify
  - Bills of material (e.g., product-specific data necessary for determining eligibility for trade benefits)
- Identify applicable rules of origin,[15] how the existing rule is currently met and how it will change
- Model the impact of proposed changes (per product) and explore solutions:
  - Would your company need to replace non-NAFTA components to comply with a stricter tariff shift rule or an increased RVC requirement?
  - How close are you to reaching the current RVC rule?
  - Would you need to use a special NAFTA provision, such as the self-produced (intermediate) materials rule to assist in meeting qualification requirements?
- Be prepared for increased enforcement, such as free trade agreement audits by local customs authorities
- Assess your company's business traveler mobility reliance on NAFTA 1.0
- Continue to monitor the impact of the Section 232 US tariffs and Canadian and Mexican retaliatory tariffs and surtaxes and take advantage of drawbacks or remissions of such tariffs or surtaxes where applicable (as discussed in other EY Tax Alerts)

[15] Set forth in NAFTA Annex 401.

For additional information, contact:

Ernst & Young LLP (United States)

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

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

Mancera, S.C. (Mexico)

Rocío Mejía, *Mexico City*
+52 55 5283 8672
rocio.mejia@mx.ey.com

Maria Teresa Gonzalez, *Queretaro*
+52 44 2216 6429
teresa.gonzalez@mx.ey.com

Ernst & Young LLP (Canada)

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

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

The EU and Japan sign Economic Partnership Agreement

The European Union (EU) and Japan signed, on 17 July 2018, the Economic Partnership Agreement (EPA). The main objective of this landmark trade deal is to facilitate trade and progressively liberalize trade in goods by eliminating trade barriers between the EU and Japan. Besides offering business opportunities to companies involved in supply chains between the EU and Japan, it also provides opportunities for businesses rendering services between the two countries.

This article summarizes business opportunities arising from this trade deal and highlights how businesses could benefit from this agreement between the EU and Japan once the agreement provisionally enters into force at the beginning of 2019.

The EU-Japan Economic Partnership Agreement

The EU-Japan EPA is the world's largest bilateral trade deal, creating the world's largest liberalized trade zone. By signing the agreement, the EU Commissioner for Trade, Cecilia Malmström, stated: "Together with Japan, we are sending a strong signal to the world that two of its biggest economies still believe in open trade, opposing both unilateralism and protectionism."[16] The scope of the EU-Japan EPA goes beyond a traditional free trade agreement, as it not only eliminates most customs duties for goods traded between the two countries, but it also liberalizes the trade in services and removes long-standing regulatory barriers. The EPA is expected to provisionally enter into force at the beginning of 2019.

Trade in goods

The EPA will gradually eliminate tariffs on most goods traded between the EU and Japan. Different business sectors will benefit from the agreement, as customs duties for a wide range of products will gradually be removed. Products benefiting under the EPA include wine, cheese, beef, and processed meat and fishery products. Furthermore, tariffs on industrial products, such as chemicals, plastics, cosmetics, textiles and apparel, will be eliminated. Another sector for which this trade deal creates significant opportunities is the automotive industry, as tariffs on cars will gradually be removed as well. Under the EPA, exporters will be allowed to self-certify their goods' origin.[17]

---

[16] Source: http://europa.eu/rapid/press-release_IP-18-4526_en.htm.

[17] For additional information about the EPA, see "EU-Japan EPA and TPP change trade landscape for Japan" in this issue of *TradeWatch*.

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, in particular, businesses trading in financial services, computer and information services, and travel and air transportation services will benefit from the EU-Japan EPA.

Removal of regulatory barriers

The EU-Japan EPA also addresses non-tariff barriers, which facilitates the access of EU companies to the highly regulated Japanese market and Japanese companies to the EU market as well. These non-tariff barriers concern, among others, motor vehicles, medical devices, textile labeling, cosmetics and beer. The EU-Japan EPA will also protect over 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 as they have in the EU and vice versa.

Impact on businesses: how can they benefit?

The EU-Japan EPA provides on a reciprocal and mutually advantageous basis benefits for companies involved in supply chains between the EU and Japan. To make use of these benefits, for example, elimination of tariffs on goods, three conditions must be met:

1. Goods shipped between the EU and Japan must obtain preferential origin "Japan" or "EU."
2. Certificates of origin (or printed origin declarations) must accompany the goods.
3. The goods are shipped directly from the EU to Japan or vice versa.

Benefiting from the preferential duty treatment essentially requires a business to bring into line its origin management with the conditions stated in the EU-Japan EPA. Accordingly, businesses should work with their local tax advisors to:

1. Assess whether goods subject to export from the EU to Japan or vice versa have obtained preferential origin
2. Identify the different stakeholders for origin management in the current supply chain setup, especially with regard to identifying who and how the required certificates of origin should be obtained
3. Optimize the supply chain to enable use of the EU-Japan EPA (or other free trade agreements) by identifying potential opportunities for simplifications and standardization and also setting out a road map to implement these optimizations

---

For additional information, contact:

Ernst & Young Tax Consultants BCVBA (Belgium)

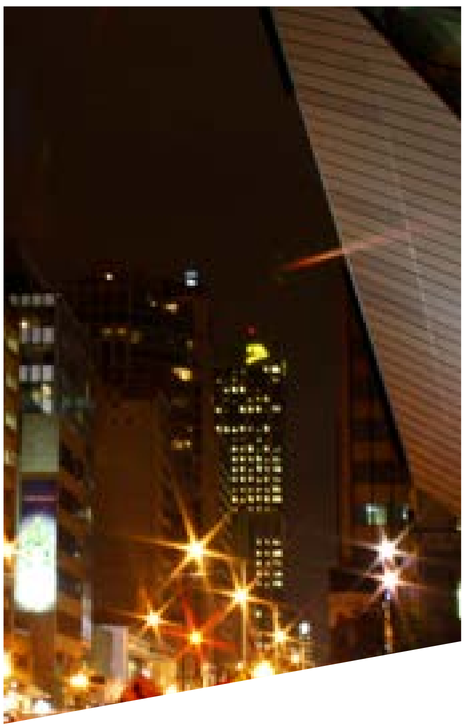
Franky de Pril, *Diegem (Brussels)*
+32 2 774 9484
franky.de.pril@be.ey.com

Ernst & Young Tax Co. (Japan)

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

Canada

Duty relief, duty drawback and remission available for Canadian surtaxes on certain US originating goods



Importers may now take advantage of the Duties Relief Program and/or Duty Drawback Program to defer or obtain a refund of the recent surtax imposed under the United States Surtax Order (Steel and Aluminum) (SOR/2018-152) and the United States Surtax Order (Other Goods) (SOR/2018-153) for imported goods that are re-exported or are used as inputs, or consumed in producing other goods for export. In addition, the federal government has announced a remission program to relieve unfair applications of the surtax or hardship in limited circumstances.

Background

Effective 1 June 2018, the United States followed through on its announcement to remove the Canadian exemption from the global "national security" interest tariffs imposed on US imports of steel and aluminum products at the rates of 25% and 10%, respectively. These tariffs were based on a previous finding by the Department of Commerce under Section 232 of the Trade Expansion Act of 1962, which concluded that the import of Canadian steel and aluminum products threatened US "national security" interests.

In response, effective 1 July 2018, Canada imposed a 25% or 10% surtax on steel and aluminum products and many consumer goods originating in the United States under two retaliatory surtax orders. Canada Border Services Agency (CBSA) issued Customs Notice 18-08 clarifying the application of the surtaxes, adding certain exceptions thereto and confirming that the Duties Relief and Duty Drawback Programs relieving measures will apply to covered goods.

The implemented tariff countermeasures

The imported goods originating in the US that are subject to Canada's countermeasures are listed under three tables released by the Department of Finance.[18] Table 1 goods are subject to a 25% surtax and cover primarily iron and steel products (including bars, rods, tubes, pipes and wires). Table 2 goods are subject to a 10% surtax and cover primarily aluminum products and many finished aluminum goods, and Table 3 goods are also subject to a 10% surtax applicable to many consumer goods, including food products, household products, recreational goods and, not surprisingly, wood and paper products.

Significant changes from the 31 May 2018 original proposed listing to the final list of goods subject to the retaliatory surtaxes were the removal of manufacturing inputs in Chapters 72, 73, 76, 85 and 90, in particular:

[18] Final tables are available at: https://www.fin.gc.ca/access/tt-it/cacsap-cmpcaa-1-eng.asp.

- 72.19 and 72.20 (flat-rolled products of stainless steel)
- 7225.11, 7225.19, 7226.11 and 7226.19 (flat-rolled products of other alloy steel (silicon-electrical steel))
- 7301.10 (sheet piling of iron or steel, whether or not drilled, punched or made from assembled elements)
- 7302.40 and 7302.90 (railway or tramway track construction material of iron or steel: fishplates, sole plates, as well as other construction material)
- 76.05 (aluminum wire)
- 7606.11 (aluminum plates, sheets and strips, of a thickness exceeding 0.2 mm, rectangular and not alloyed)
- 76.08 (aluminum tubes and pipes)
- 76.09 (aluminum tubes or pipe fittings (e.g., couplings, elbows, sleeves))
- 85.37 (boards, panels, consoles, desks, cabinets and other bases, equipped with two or more apparatus of heading 85.35 or 85.36, for electric control or the distribution of electricity, including those incorporating instruments or apparatus of Chapter 90, and numerical control apparatus, other than switching apparatus of heading 85.17)
- 90.32 (automatic regulating or controlling instruments and apparatus)

The surtaxes apply to US origin goods based on the Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations (essentially US tariff NAFTA origin goods). Non-US origin goods transiting through the US to Canada and non-US origin goods distributed from the US to Canada are not subject to the surtaxes.

Clarifying points of interest

It is important to note that goods listed in Tables 1, 2 and 3 referred to above (which correspond to Schedules 1 and 2 of the United States Surtax Order (Steel and Aluminum) and the Schedule to the United States Surtax Order (Other Goods) that are also listed under provisions in Chapters 98 and 99 of the Schedule to Canada's Customs Tariff are subject to the surtaxes, even though they are entitled to a preferential tariff rate of customs duty under these concessionary chapters (usually duty free), subject to a few exceptions in Chapter 98. The exceptions include conveyances and containers engaged in international commercial transportation, temporary imports of conveyances and baggage for noncommercial purposes, travelers' exemptions (e.g., the 48-hour or seven-day exemptions) and certain settler's effects.

Duties relief or drawback is available

Canada's Duties Relief and Duty Drawback Programs continue to be available to importers for surtaxes paid or otherwise owing by Canadian businesses that meet the requirements of the programs. This means that duty deferral can apply to the surtax subject goods that are destined for re-export or as inputs therefor, and duty drawback can apply where the goods are exported or destroyed without use in Canada or are used as inputs in exported goods.

Duty Drawback Program

The Duty Drawback Program provides a *refund* of the surtax imposed under the orders for goods that are:

- Exported in the same condition as imported
- Further processed then exported
- Used as a display or for demonstration
- Used as inputs to produce other goods for export

To obtain a refund, qualifying importers must complete the appropriate claim form and attach all necessary documentation to substantiate the import, export and processing (if applicable).

Duties Relief Program

The Duties Relief Program provides for relief of the surtaxes, at time of importation, as long as one of the following conditions is met:

- Goods are exported in the same condition as imported.
- Goods are imported for further processing and exported.
- Goods are displayed or demonstrated in Canada.
  Or
- Goods are used in the production or development of goods for export.

Importers must apply in advance to the CBSA, demonstrating that their record-keeping is satisfactory to support a request for duty relief and that the subject goods qualify.

The CBSA will conduct an on-site validation, and, once approved, an authorization number will be provided that will grant the importer relief from payment of the surtax at the time of importation. It will remain the obligation of the importer to pay the surtax if goods become nonqualifying post-importation. Note that authorization does not apply retroactively: surtaxes paid on goods imported prior to receiving authorization can be recovered through a drawback claim once the goods are exported from Canada.

If the goods are sold or transferred to another company in Canada, that company must be registered under the Duties Relief Program in order to benefit from the relief of the surtax.

Remission of surtaxes

The Minister of Finance, under Section 115 of the Customs Tariff, has the authority to recommend remission to the Governor in Council for relief and refund of the recently imposed surtaxes.

The remission of the surtax[19] is used to address exceptional and compelling circumstances that from a public policy perspective are found to outweigh the primary rationale behind the application of the surtaxes. Specifically, the federal government will consider requests for remission of the surtaxes that took effect on 1 July in the following instances:

- To address situations of short supply in the domestic market
- If there were contractual requirements, existing prior to 31 May 2018, for Canadian businesses to use US steel or aluminum in their products or projects
- To address, on a case-by-case basis, other exceptional circumstances that could have severe adverse impacts on the Canadian economy by imposing hardship on Canadian companies

Impact for businesses

Businesses in the automotive parts, steel, aluminum, metal stamping, export manufacturing, oil and gas, and construction sectors will likely benefit most from both programs and the remission of surtax.

Regarding remission of the surtaxes, interested parties can make the application in the required format complete with all necessary information. Only companies registered in Canada are eligible to submit requests for remission. Importers interested in applying for remission must ensure that their submissions are completed correctly and in a timely fashion, as the granting of remission does involve some delay, and remissions will not be granted if the information provided is incomplete, inaccurate or not compelling from a sound tax policy and fairness point of view.

Likewise, the Duties Relief and Duty Drawback Programs require that importers meet certain administrative requirements to qualify for the programs, and importers must continuously demonstrate compliance with program requirements to remain eligible and avoid fines or penalties. As trade tensions in North America and around the globe show no signs of abating, importers would be wise to act expeditiously to take advantage of the aforementioned programs if they are eligible to do so.

For additional information, contact:

Ernst & Young LLP (Canada)

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

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

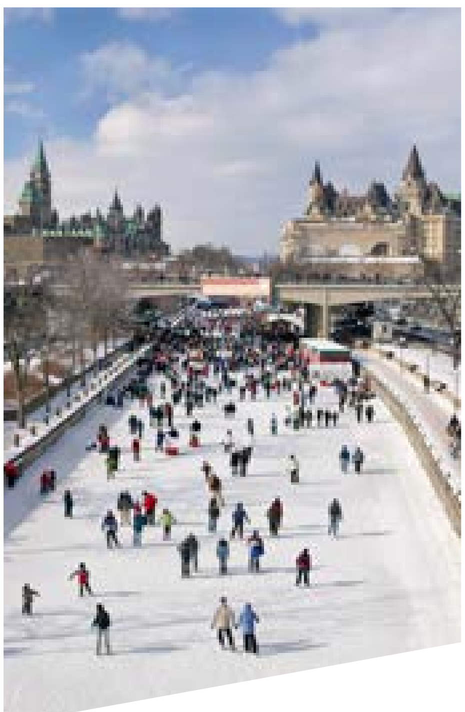
Ray Fischer, *Toronto*
+1 416 932 5975
ray.fischer@ca.ey.com

Katherine Xilinas, *Vancouver*
+1 604 899 3553
katherine.xilinas@ca.ey.com

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

[19] Text available at: https://www.fin.gc.ca/access/remis-eng.asp.

Canada updates trade compliance verification list



On 6 July 2018, the Canada Border Services Agency (CBSA) released its semiannual list of trade compliance verification (audit) priorities designed to update the importing community on ongoing verification priorities and set the stage for new priorities for the upcoming calendar year.

At the midpoint of 2018, the CBSA remains focused on tariff classification as a priority audit area, with the introduction of three new tariff classification product categories and five new rounds to the list of existing priorities.

Background

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

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

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

Random verifications

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

Targeted verification priorities

Targeted verification priorities are established using a risk-based, evergreen process. New targets are added throughout the year. Verification priorities may also be carried over from previous years.

Importers that deal in products or industries that are outside the targeted verification priorities should not presume that they will avoid a verification this year. Through random verifications, the CBSA continues to verify importers in sectors and industries not included in the list of verification targets.

Verification priorities: updated targets

The second release of verification priorities for 2018 encompasses 39 tariff classification verification priorities

(including 3 new priorities for classification in the second half of 2018), 1 valuation verification priority and 2 origin verification priorities.

The continued focus on tariff classification may be due to the relative ease of verifying that goods have been classified correctly for customs purposes. Increased audit activity in this program may also lead to higher revenues for the CBSA.

The following chart lists all current tariff classification priority items:

Verification priority: tariff classification		
Curling irons	Tubes, pipes and hoses	Nails and similar articles of iron or steel
Furniture for non-domestic purposes	Parts of lamps	Castors with mountings of base metal
Seaweed	Chemical products	Pickled vegetables **(new additional round)**
Dextrins and other modified starches	Pasta	Mineral waters and aerated waters
Batteries **(new additional round)**	Hair dryers and electric smoothing irons	Gloves
Footwear **(CAD30 or more per pair)**	Cell phone cases **(new additional round)**	Pebbles, limestone and granules
Hair extensions	Mountings, fittings and similar articles	Spent fowl
Parts for power trains	Handkerchiefs, towels and related paper products	Safety headgear
Articles of apparel and clothing accessories	Olive oil **(new additional round)**	Bags
Bicycle parts	Photographic film	Import permit numbers
Articles of plastics	Stone blocks and slabs **(new additional round)**	Other mountings and fittings, suitable for furniture **(new)**
Vices and clamps	Railway equipment	Air heaters and hot air distributors **(new)**
Parts for use with machinery of Chapter 84	Sacks and bags under tariff item 9903.00.00	Flashlights and miners' safety lamps **(new)**

The CBSA has identified three new product categories for tariff classification verification priorities — other mountings and fittings suitable for furniture, air heaters and hot air distributors, and flashlights and miners' safety lamps — and has opened an additional round of verification for five product categories.

The CBSA remains focused on its previously identified valuation priority target, the apparel industry, as well as bedding and T-shirts.

Importers of apparel and similar fashion articles (e.g., footwear, fashion accessories, imitation jewelry) should assess whether they are prepared for a valuation verification audit. Importers that purchase goods from related parties and use transfer pricing as the basis for customs values should consider their record-keeping obligations and whether the documentary support on record is sufficient to defend the use of a transfer price as the basis for customs value.

Two origin verification priorities listed by the CBSA that remain ongoing since the last listing of verification priorities relate to the North American Free Trade Agreement (NAFTA): T-shirts, and bedding and drapery. The purpose of a NAFTA origin verification is to determine whether goods imported into Canada are entitled to the NAFTA preferential rate of duty.

Takeaways for importers

CBSA verifications can be time-consuming and costly for importers. Companies must be proactive and adopt an informed compliance mindset. Leading practices for companies include implementing programs, frameworks and methodologies to help maintain and continuously improve their customs and trade compliance profile.

For additional information, contact:

Ernst & Young LLP (Canada)

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

Ray Fischer, *Toronto*
+1 416 932 5975
ray.fischer@ca.ey.com

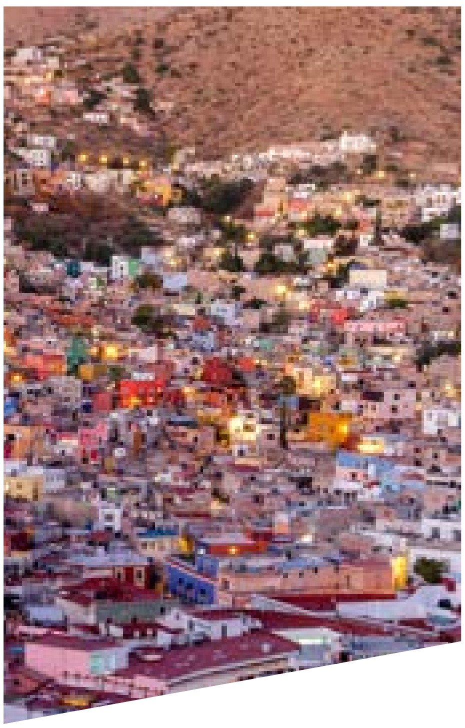
Sylvain Golsse, *Montréal*
+1 514 879 2643
sylvain.golsse@ca.ey.com

Katherine Xilinas, *Vancouver*
+1 604 899 3553
katherine.xilinas@ca.ey.com

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

Mexico

Mexico takes retaliatory measures against US imposition of steel and aluminum tariffs



On 23 March 2018, President Trump imposed additional duties on steel and aluminum, based on the United States Department of Commerce's investigations and recommendations under Section 232 of the Trade Expansion Act of 1962, as amended, which concluded that certain imports of these items threatened to impair the national security of the United States (US).

Mexico, Canada and the European Union (EU) were temporarily excluded from these tariffs. Notwithstanding the above, on 31 May 2018, the US announced that it would suspend the previous exemptions granted for the additional tariffs of 25% on specifically defined articles of steel and additional tariffs of 10% on specifically defined articles of aluminum goods imported into the US from the previously excluded North American Free Trade Agreement (NAFTA) countries and the EU.

Mexico, Canada and the EU swiftly announced retaliatory actions to be taken commensurate with the anticipated duty impacts to their respective country exports. On 5 June 2018, the Mexican Government published the list of products that, effective on that date, are subject to a retaliatory duty. Such duties only apply on permanent imports; therefore, temporary imports, such as those conducted under Mexico's Manufacturing Industry, Maquiladora and Export Services (IMMEX) program will not be affected.

The Mexican Government has stated that it considers the measures adopted by the US to constitute safeguards, and therefore, the US should have followed the notice and consultation procedure established under Chapter VIII: Emergency Measures under NAFTA. Because the US did not follow this procedure, the US did not comply with its obligations under NAFTA, and accordingly, the Mexican Government has the right to impose measures that have substantially equivalent commercial effects to those adopted by the US. These measures include:

- Suspension of preferential duty treatment on the importation of the listed goods
- Increase on the import duty rate for the listed goods originating in the US

These measures will be in effect until the US stops applying the additional tariffs on articles of steel and aluminum on Mexican imports. The Mexican Government issued the official list of US products affected by the retaliatory duties, ranging from 7% to 25%. These duties were imposed on an estimated USD3 billion worth of US goods. Relevant products subject to the retaliatory duties include steel products (25% duty), pork products (20% duty), fresh cheese (25%), apples (20%) and bourbon (25%).

The duties apply on products originating from the US that are imported on a permanent basis into Mexico; however, the temporary importation of these products that will be subsequently exported from Mexico (i.e., IMMEX) will not be subject to these additional duties.

The Mexican Government has stated that it may adjust the list of products originating from the US that will be subject to the retaliatory duties. This may imply that Mexico will make periodic adjustments to the list of products using what is generally referred to as the "carousel" method.

Under the carousel method, products can be rotated on and off the list, and this type of retaliation may serve as a powerful tool to pressure the US Government by generating incentives to mobilize affected industries in the US that can promote a solution to the issue.

For additional information, contact:

Ernst & Young LLP (United States)

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

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

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

Mancera, S.C. (Mexico)

Rocío Mejía, *Mexico City*
+52 55 5283 8672
rocio.mejia@mx.ey.com

United States

US issues new steel and aluminum proclamations outlining potential relief opportunities for US importers

On 29 August 2018, United States (US) President Trump signed two presidential proclamations granting targeted relief to US importers of steel and aluminum products that are subject to country-specific quotas covered by Section 232 of the Trade Expansion Act of 1962. For imports of steel and aluminum subject to country-specific quotas, interested parties can apply for a product-specific exclusion from quantitative limitations on steel and aluminum under a process that will be similar to the existing product exclusion process established for the relief of punitive tariffs. Steel and aluminum products relieved from quantitative limitations under this process will not be subject to punitive tariffs.

Under a separate process, relief from steel quotas, but not aluminum quotas, may be available to companies involved in large domestic construction projects when importers are experiencing closed or nearing capacity quotas, but only where the transaction meets certain requirements.[20] The relief mechanism is intended to address instances where previously contracted purchases of steel were imported following imposition of the initial duty orders, but where specific circumstances show that US economic impacts have resulted due to cost increases, denial of imports upon clearance and, thus, project delays and other factors. Relief is effectively limited to allowing imports without quota restrictions; however, the punitive duty rates will still apply.

Steel and aluminum quota exclusion process

As of 1 June 2018, steel quotas have been imposed on Argentina, Brazil and South Korea, while aluminum quotas were imposed on Argentina. Through the new relief process, companies can apply for product-specific exclusions where they can demonstrate that there exists an insufficient quantity or quality available from US steel or aluminum producers or based upon specific national security reasons, thus excluding the product from the applicable quantitative limitation. This criteria will mirror the criteria currently being used for the existing product exclusion process, which grants relief from punitive tariffs. To the extent that a product exclusion from quantitative limitations is granted, the product will not be subject to punitive duties.[21]

[20] For background on the steel and aluminum tariffs and quotas implemented under Section 232 of the Trade Expansion Act of 1962, see EY Global Tax Alert, "US suspends tariff exemptions on steel and aluminum for EU and NAFTA countries; EU, Canada and Mexico to impose retaliatory duties on a wide range of products," dated 31 May 2018.

[21] For steel, see "Presidential Proclamation Adjusting Imports of Steel into the United States, Clause 1" (29 August 2018). For aluminum, see "Presidential Proclamation Adjusting Imports of Aluminum into the United States, Clause 1" (29 August 2018).

Relief on steel and aluminum products subject to quota restrictions will be granted on a party-by-party basis, taking into account the regional availability of particular articles. The relief will only apply to an article entered for consumption, or withdrawn from a warehouse for consumption, on or after the date on which the relief request was approved. Products granted exclusion from the quota restrictions will be counted toward any quantitative limitation previously proclaimed until such limitation has been filled.

Steel quota exclusion process for construction projects

The steel proclamation further acknowledges that the country-specific steel quotas previously imposed have significantly disrupted or delayed certain large construction projects in the US that employ thousands of workers. In several instances, critical steel articles, which were contracted for purchase prior to the implementation of quotas, cannot be entered into the US since the quantitative limitations have already been reached. As a result, the steel proclamation creates a separate process whereby limited relief from quantitative limitations will be granted based on meeting the following criteria:[22]

1. The party requesting relief entered into a written contract for production and shipment of the steel article **before 8 March 2018**.
2. The contract specifies the quantity of the steel article that is to be produced and shipped to the US consistent with a schedule contained in the contract.
3. The steel article is to **be used to construct a facility in the US** and the steel article cannot be procured from a supplier in the US to meet the delivery schedule and specifications contained in the contract.
4. The payments made pursuant to the contract constitute **10% or less of the cost of the facility** under construction.
5. Lack of relief from the quantitative limitations on the steel article would **significantly disrupt or delay completion of the facility being constructed in the US** with the steel article specified in the contract.

In addition to the above criteria, a party seeking relief under this process must also submit a sworn statement signed by the company's chief executive officer and chief legal officer.[23]

The statement must attest to the following:

- The steel article for which relief is sought and the associated contract meet all of the criteria for relief set forth in the proclamation.
- The party requesting relief will accurately report to Customs and Border Protection (CBP), in the manner that CBP prescribes, the quantity of steel articles entered for consumption, or withdrawn from a warehouse for consumption, pursuant to any grant of relief.
- The quantity of steel articles entered pursuant to a grant of relief will not exceed the quantity specified in the contract for delivery on or before 31 March 2019.

If at any time after granting relief the Department of Commerce determines that the criteria has not been met, Commerce has been instructed to notify the Attorney General and revoke any relief previously granted.

While the proclamation offers exclusion from quantitative restrictions imposed on steel imported from Argentina, Brazil and South Korea, any steel article granted relief will be subject to the 25% punitive tariff. The proclamation also stipulates that any steel article granted relief must be entered for consumption, or withdrawn from a warehouse for consumption, on or before 31 March 2019.

Actions for businesses

Importers of steel from Argentina, Brazil, South Korea and/or aluminum from Argentina should consider whether they qualify under these relief actions. Specifically, if importers from these countries can support the argument that there is a lack of availability and/or quality in the US or there is a compelling national security argument, a product exclusion request should be considered. To date, approximately 35,000 steel and aluminum exclusion submissions have been filed with the government seeking exclusion relief, with 4,500 decisions made (13%), seeing an approximate approval rate of 55%.

Importers of steel that have entered into contracts for US-based construction projects and shipment of foreign steel in advance of 8 March 2018 (with consideration of the project end date) should consider requesting relief from the quota. It bears mentioning again, however, that under this quantitative relief scenario, the punitive tariffs of 25% will apply.

For additional information, contact:

Ernst & Young LLP (United States)

James Lessard-Templin, *Portland*
+1 503 414 7901
james.lessardtemplin@ey.com

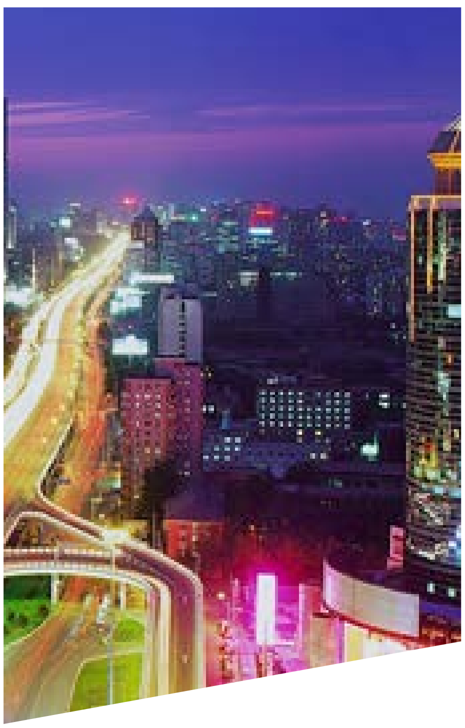
Lynlee Brown, *San Diego*
+1 858 535 7357
lynlee.brown@ey.com

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

[22] "Presidential Proclamation Adjusting Imports of Steel into the United States, Clause 2" (29 August 2018).

[23] "Presidential Proclamation Adjusting Imports of Steel into the United States, Clause 3" (29 August 2018).

US-China trade dispute escalates with punitive tariffs implemented on a total of USD360 billion of trade between the two nations



The trade dispute between the US and China has continued to escalate with both nations implementing a second round of punitive tariffs against one another in August followed by a third and much larger round of tariffs starting as of 24 September 2018.[24] The total amount of additional tariffs levied against China-origin goods imported into the US has now risen to USD250 billion, while China has implemented a smaller amount of punitive duties, USD110 billion, against US-origin goods.[25] Although the total amount of tariffs imposed on US-origin goods are less than half of those imposed by the US, additional duties will impact nearly 85% of US exports to China based on publicly available figures from 2017.[26]

Summary of US and China actions

Country	Product list	Tariff lines listed	Additional tariffs	Trade in USD	Effective date
US actions					
US	List 1	818	25%	$34b	6 July 2018
US	List 2	279	25%	$16b	23 August 2018
US	List 3	5,745	10% (23 September-31 December 2018) 25% (1 January 2018 forward)	$200b	24 September 2018
China actions					
Country	Product list	Tariff lines listed	Additional tariffs	Trade in USD	Effective date
China	List 1	545	25%	$34b	6 July 2018
China	List 2	333	25%	$16b	23 August 2018
China	List 3	5,207	5%, 10%	$60b	24 September 2018

[24] "USTR Finalizes Tariffs on $200 Billion of Chinese Imports in Response to China's Unfair Trade Practices." See https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/september/ustr-finalizes-tariffs-200.

[25] China Ministry of Commerce, "Announcement on Imposing Tariffs on Some Goods Originating in the US," 17 June 2018.

[26] US Census Bureau, Foreign Trade, US Trade in Goods with China – 2017.

Analysis of US actions pursuant to Section 301 and China's response

US implements USD50 billion of tariffs on China-origin goods in two separate actions

The US action is being taken unilaterally under Section 301 of the Trade Act of 1974 (Section 301), which allows the US Trade Representative (USTR) to impose duties or import restrictions upon a determination that an act, policy or practice of a foreign country violates, or is inconsistent with, a trade agreement, such as the World Trade Organization (WTO), or is "unjustifiable and burdens or restricts United States Commerce."[27] The USTR Section 301 investigation focused on China's acts, policies and practices related to technology transfer, intellectual property and innovation and began in August 2017. As a result of the USTR's investigation, the US announced on 3 April 2018 that it was targeting more than 1,000 unique tariff lines for an additional 25% ad valorem duties that spanned 18 chapters of the Harmonized Tariff Schedule of the United States (HTSUS) and covered USD50 billion worth of imports from China.[28]

The USTR's methodology targeted products related to the "Made in China 2025" policy and was designed to minimize the impact on US consumers by selecting products with commercially feasible alternative sourcing options. As a result, the proposed and final lists exclude major categories of consumer goods, such as footwear, apparel and smartphones, and most consumer electronics, such as personal computers and computer monitors.

The USTR has since revised its initial list and recently implemented 25% ad valorem punitive tariffs (calculated in addition to most favored nation duties) in two separate actions. First, the USTR implemented additional duties against 818 tariff lines covering USD34 billion worth of imports from China per year (US List 1), which became effective 6 July 2018.[29] While US List 1 spans nine chapters of the HTSUS (Chapters 28, 40 and 84 through 90), Chapter 84 contains the largest quantity of covered products. Second, the USTR implemented tariffs against another 279 tariff lines covering USD16 billion worth of imports from China per year (US List 2), which became effective 23 August 2018.[30] US List 2 focuses on Chinese products, such as lubricating oils, greases, preparations and certain related additives, from HTSUS Chapters 27, 34 and 38; plastics and articles thereof from Chapter 39; semiconductor manufacturing equipment from Chapter 84; engines, motors and generators from Chapters 84, 85 and 87; certain electronics and electronic parts/components, including integrated circuits from Chapter 85; as well as various vehicles, tractors and vessels from Chapters 84, 86, 87 and 89.

Summary of US Lists 1 and 2: implemented tariffs

Rank	Tariff chapter	Tariff chapter description	Number of tariff lines listed
1	84	Nuclear reactors, boilers, machinery and mechanical appliances …	448
2	85	Electrical machinery and equipment and parts thereof …	222
3	39	Plastics and articles thereof	146
4	90	Optical … measuring, checking, precision, medical or surgical …	145
5	87	Vehicles, other than railway or tramway rolling stock, and parts …	60
6	86	Railway or tramway locomotives, rolling stock, parts thereof …	30
7	88	Aircraft, spacecraft and parts thereof	15
8	89	Ships, boats and floating structures	11
9	73	Articles of iron or steel	6
10	27	Mineral fuels, mineral oils and products of their distillation …	3
All other tariff chapters – 28, 34, 38, 40, 70, 76			11
Grand total			1,097

[27] 19 USC § 2411 et seq.

[28] For further background, see *TradeWatch* Vol 17, Issue 2 (June 2018), "US to impose USD34 billion in tariffs on China-origin goods effective 6 July 2018; additional USD16 billion to follow."

[29] "USTR Issues Tariffs on Chinese Products in Response to Unfair Trade Practices," 15 June 2018.

[30] "USTR Finalizes Second Tranche of Tariffs on Chinese Products in Response to China's Unfair Trade Practices," 7 August 2018.

China implements USD50 billion of tariffs on US-origin goods

China responded to the US actions by implementing punitive tariffs of 25% ad valorem on 878 unique tariff lines covering USD50 billion worth of imports from the US. The duties were levied in two waves. First, China implemented additional duties against 545 tariff lines covering USD34 billion worth of imports from the US (China List 1), which became effective on the same day as US List 1, 6 July 2018.[31] The list primarily targets agricultural products (approximately 500 tariff lines), such as meat, seafood, dairy, produce, nuts and grains. China List 1 also covers alcohol, whiskey, tobacco products, cotton, gearboxes and vehicles, such as electric cars, hybrid cars and small-engine vehicles. Second, China implemented tariffs on another 333 tariff lines covering USD16 billion worth of imports (China List 2), which became effective on the same day as US List 2, 23 August 2018.[32] China List 2 includes various types of vehicles and parts thereof of Chapter 87; plastic products; certain coal, oil (but notably omits US crude oil) and natural gas products; medical devices; fish meal; paper, wood and metal scrap/waste; among other products.

.

Summary of China Lists 1 and 2: implemented tariffs

Rank	Tariff chapter	Tariff chapter description	Number of tariff lines listed
1	87	Vehicles, other than railway or tramway rolling stock, and parts …	206
2	03	Fish and crustaceans, mollusks and other aquatic invertebrates	182
3	07	Edible vegetables and certain roots and tubers	93
4	08	Edible fruit and nuts; peel of citrus fruit or melons	86
5	27	Mineral fuels, mineral oils and products of their distillation …	64
6	02	Meat and edible meat offal	48
7	16	Preparations of meat, of fish or of crustaceans, mollusks …	41
8	04	Dairy produce; bird's eggs; natural honey; edible products of animal …	21
9	10	Cereals	14
10	39	Plastics and articles thereof	13
All other tariff chapters (33 chapters)			110
Grand total			878

[31] China Ministry of Commerce, "Announcement on Imposing Tariffs on Some Goods Originating in the US," 17 June 2018.

[32] China Ministry of Finance, "Announcement of the Customs Tariff Commission of the State Council on Adding Tariffs to Imported Goods Originating from the United States of About US$16 Billion," 8 August 2018.

US finalizes an additional USD200 billion of tariffs; China counters with an additional USD60 billion

In response to China's implementation of List 2, the USTR announced additional tariffs on 5,745 tariff lines covering USD200 billion worth of imports from China (US List 3). China-origin products are subject to additional 10% ad valorem punitive tariffs as of 24 September 2018. The duty rate for covered products on US List 3 will then increase to 25% on 1 January 2019.

While US List 3 is the most expansive of the US actions, covering products that span 80 different chapters of the HTSUS, pharmaceuticals of Chapter 30 and apparel and footwear of Chapters 61 through 64 are notably absent from the list. Unlike prior actions, US List 3 includes a significant amount of consumer products, such as car parts, appliances, televisions, batteries, computer components and network routers, furniture, hats and handbags, among others. US List 3 also covers fabrics, food, chemicals and pesticides, minerals, machines, items made from steel and aluminum, and semiconductor assemblies, among others.

The list is broken up into two parts. Part one contains 5,734 full tariff lines that are subject to punitive tariffs, while part two contains 11 eight-digit tariff numbers where only a portion of the codes' subheadings are subject to punitive tariffs. In other words, certain 10-digit tariff lines are excluded, despite the inclusion of the corresponding 8-digit line. For example, seats under 9401.80.60 are subject to punitive tariffs, except for child safety seats classified under 9401.80.6021 and 9401.80.6023.

Notably, part two covers 8517.62.00 but excludes 8517.62.0090, which is a subheading that does not currently appear in the existing version of the HTSUS. HTSUS subheading 8517.62 covers "machines for the reception, conversion and transmission or regeneration of voice, images or other data, including switching and routing apparatus" and consists of two potential subheadings, 8517.62.10 covering "modems" and 8517.62.50 covering "other." The USTR did specify that smart watches and Bluetooth devices will not be subject to punitive duties. If the USTR's exclusion of 8517.62.0090 is a typographical error, it is likely a reference to 8517.62.0050 because smart watches and Bluetooth devices are currently classified as 8517.62.0050 under the existing version of the HTSUS; however, if it is not an error, there is a possibility that the USTR has signaled its intention to create a new HTSUS code in order to allow Customs and Border Protection (CBP) to more easily identify covered items when assessing additional duties.

Summary of US List 3: proposed tariffs

Rank	Tariff chapter	Tariff chapter description	Number of tariff lines listed
1	29	Organic chemicals	693
2	03	Fish and crustaceans, mollusks and other aquatic invertebrates	275
3	28	Inorganic chemicals; organic or inorganic compounds of precious …	231
4	52	Cotton	230
5	48	Paper and paperboard; articles of paper pulp, of paper …	222
6	85	Electrical machinery and equipment and parts thereof …	213
7	84	Nuclear reactors, boilers, machinery and mechanical appliances …	196
8	44	Wood and articles of wood; wood charcoal	180
9	38	Miscellaneous chemical products	142
10	07	Edible vegetables and certain roots and tubers	143
All other tariff chapters (70 chapters)			3,220
Grand total			5,745

In response, China finalized a list of 5,207 product lines covering USD60 billion of commerce with the US that are subject to additional tariffs of 5% and 10% ad valorem as of 24 September 2018 (China List 3).[33] Notably, the list includes liquefied natural gas, auto parts, medical devices, various types of machinery, furniture, minerals, chemicals, leather products, wood products, as well as food and beverage products, such as meat, coffee, nuts and alcoholic drinks.

Summary of China List 3: proposed tariffs

Rank	Tariff chapter	Tariff chapter description	Number of tariff lines listed
1	84	Nuclear reactors, boilers, machinery and mechanical appliances ...	734
2	85	Electrical machinery and equipment and parts thereof ...	459
3	29	Organic chemicals	344
4	28	Inorganic chemicals; organic or inorganic compounds of precious ...	220
5	90	Optical ... measuring, checking, precision, medical or surgical ...	208
6	72	Iron and steel	159
7	73	Articles of iron or steel	136
8	39	Plastics and articles thereof	132
9	62	Articles of apparel and clothing accessories, not knitted or crocheted	120
10	44	Wood and articles of wood; wood charcoal	109
All other tariff chapters (84 chapters)			2,586
Grand total			5,207

US announces product exclusion process for items subject to US List 2

On the same day as finalization of US List 3, the USTR announced a product exclusion process for US List 2. Similar to the exclusion process outlined for products on US List 1, exclusion requests must specify a particular product that is classified within a HTSUS subheading based on physical characteristics that distinguish it from other products within the covered eight-digit subheading. Importers must also provide the applicable 10-digit HTSUS subheading for the item, as well as the annual quantity and value of the China-origin product that the requester purchased in each of the last three years. Only one product may be submitted per exclusion request.

[33] China Ministry of Finance, "Announcement of the Customs Tariff Commission of the State Council on the Imposition of Tariffs on imports of $60 Billion of Certain Imports Originating in the United States," 18 September 2018.

Unlike the US List 1 exclusion process, requesters seeking to exclude imported China-origin parts that are used in production of final products must provide the percentage of the total cost of China-origin input and the percentage of their total gross sales in 2017. For China-origin imports that are sold as final products, requesters must provide the percentage of their total 2017 gross sales that sales of the China-origin product accounted for.

Product exclusions may be filed until 18 December 2018, and exclusions granted by the USTR will retroactively apply to 23 August 2018.

What to expect next?

On 17 September 2018, prior to Beijing's finalization of China List 3, the White House announced that additional items valued at USD267 billion will become subject to punitive tariffs should China continue to take reactive measures. This list of products would essentially cover the full universe of imports from China. A commensurate response from China is expected, although countermeasures will need to include both tariff and non-tariff actions in order to meet the magnitude of US actions.

Actions for businesses

Companies that rely on or supply China-origin goods to the US and, conversely, those that rely on or supply US-origin goods to China should review their products to confirm whether they are impacted by either the US or China lists. Those that are negatively impacted by the additional duties, including manufacturers, distributors and consumers, should map their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs and alternative sourcing options and to assess any opportunities to mitigate impact. They should also consider filing product exclusion requests before 9 October 2018 for Chinese goods covered by US List 1 and before 18 December 2018 for Chinese goods covered by US List 2. Companies should also closely monitor the USTR for announcements of exclusion processes for US List 3.

With three rounds of punitive tariffs implemented, a prolonged trade dispute, with substantial trade disruption, has materialized. Previous negotiations between the two nations have not been successful in addressing China's technology licensing practices, and both nations have filed WTO complaints. Any company involved in US-China trade is encouraged to identify the potential impact of additional duties and develop duty avoidance or mitigation strategies. Immediate actions for such companies could include:

- Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs and alternative sourcing options and to assess any opportunities to mitigate impact, such as tariff engineering
- Identifying strategies to defer, eliminate or recover the excess duties, such as bonded warehouses, Foreign-Trade Zones, substitution drawback and equivalent programs under China's customs regulations
- Exploring strategies to minimize the customs value of imported products subject to the additional duties, such as altering the chain of sale, re-evaluating current transfer pricing approaches and, for US imports, considering US customs strategies, such as First Sale for Export, especially for Chinese-based companies that sell through multi-tier transaction structures to the US

For additional information, contact:

Ernst & Young LLP (United States)

James Lessard-Templin, *Portland*
+1 503 414 7901
james.lessardtemplin@ey.com

Lynlee Brown, *San Diego*
+1 858 535 7357
lynlee.brown@ey.com

Japan

EU-Japan EPA and TPP change trade landscape for Japan

On 17 July 2018, Japan and the European Union (EU) signed an Economic Partnership Agreement (EPA), which is expected to enter into force sometime in 2019. Two days later, the Trans-Pacific Partnership (TPP) also took a step forward, with Singapore becoming the third country to ratify the agreement. The size and scope of the agreements present a major opportunity for Japanese firms.

Japan-EU EPA

The EU and Japan began negotiating their agreement in March 2013. They reached a general consensus in July 2017, and negotiations were finalized in December of the same year. Based on 2017 figures, the free trade area created by this pact will cover approximately 30% of global GDP and 40% of world trade. According to the Japanese Ministry of Foreign Affairs, approximately 99% of EU duties on Japanese products will be eliminated; in turn, Japan will remove approximately 94% of its tariffs on EU goods.[34] The EPA is likely to have a particular impact on manufacturing, as it prescribes for the eventual elimination of all duties on industrial products by both sides. EU duties on most Japanese cars will be removed immediately, with the remainder being repealed in eight years. Most Japanese auto parts, general machinery, chemicals and electronics will also no longer be subject to import duties upon implementation of the agreement.

In addition, duties on a majority of Japanese agricultural products, including the export priority goods of beef, tea and seafood, will ultimately be reduced to zero. Conversely, Japanese duties on EU agricultural products, including wine, processed pork and certain types of cheese, will also be removed. Most of these tariff eliminations, too, will take place immediately. The agreement also provides for geographical indication (GI) protections.

One important point regarding the new EPA is its provision allowing the producer, exporter or importer of a given product to make a statement certifying that item's place of origin. This means that Japanese exporters will no longer be required to obtain a certificate of origin from the Japan Chamber of Commerce and Industry. Should the EU authorities request to verify the claim of preferential origin status, the certifying party will be required to provide detailed information, such as the production process and materials used in manufacturing. If the verification request involves contacting a Japan-based exporter or manufacturer, Japanese customs authorities will also assist in responding to such requests.

[34] For details, see Ministry of Foreign Affairs report at https://www.mofa.go.jp/files/000013835.pdf.

In order to be considered of Japanese origin, items must satisfy one of three conditions:

1. Being wholly obtained or produced in Japan
2. Being made within the country from exclusively domestic materials
   Or
3. Undergoing manufacturing operations in Japan that fulfill certain product-specific criteria

Examples of these criteria include adding a certain percentage of total product value, falling under a specific manufacturing process and causing a change in HS code heading. Due to the accumulation clause in the EPA, value added in the EU can also be considered when determining whether the value percentage criteria are met.

Advances on the TPP

On 19 July 2018, Singapore became the third of the eleven signatories, after Mexico and Japan, to ratify the TPP. The agreement will enter into effect 60 days after the sixth country completes its domestic approval procedures.

That same day, at a meeting of chief negotiators in Hakone, Japan, the participating countries agreed to aim for the implementation of TPP in 2019, possibly at the beginning of the year. They also decided to begin looking at the expansion of the pact to other countries following its entry into force. More details are expected to be unveiled later this year. Thus far, a number of countries, such as the United Kingdom, South Korea and Colombia, have looked into joining the agreement.

TPP details

In addition to expanding Japan's free trade agreement (FTA) network to include Canada and New Zealand, the agreement contains other provisions that will be of interest to Japanese exporters. Similar to the Japan-EU EPA, the TPP allows for accumulation, meaning that any value added in a participating country can be applied toward product-specific rules of origin requirements. Likewise, the TPP permits producers, exporters and importers to self-certify origin.

One point of distinction between the Japan-EU EPA and the TPP lies in the rules surrounding verification of origin. In the case of Japanese exports under the TPP, Japanese customs authorities are only involved in the verification process when requested by the country for which an export is destined.

Actions for businesses

The potential for two major trade agreements to come into play next year presents many opportunities for businesses in Japan. In order to take advantage of the possible benefits from these programs, companies should familiarize themselves with the details of the tariff reduction schedules and, if potential cost savings are available, confirm whether their products abide by the relevant rules of origin. While neither agreement is expected to enter into force until at least next year, businesses should act soon to ensure that they are fully prepared to utilize all applicable provisions from the start. In particular, they should ensure that they are able to produce the documents to demonstrate originating status and preserve them for the required period. Companies may also wish to explore solutions such as the use of technology.

For additional information, contact:

Ernst & Young Tax Co. (Japan)

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

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

New Zealand

New Zealand makes major changes to customs legislation with Customs and Excise Act 2018

In 2013, the New Zealand Customs Service (NZCS) embarked on the process of reviewing and modernizing the current customs legislation. The Customs and Excise Act 2018 (the Act) represents a major rewrite of the current customs legislation. The new legislation is effective 1 October 2018.

Key changes under the Act

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

Some of the substantial changes under the Act include:

- Ability to store records offshore or in the cloud
- Introduction of Inland Revenue style compensatory interest and late payment penalties
- Ability of the NZCS to issue binding valuation rulings
- Ability of importers to declare a provisional value for goods in specific circumstances and declare a final value later

Importers need to start considering the impact of the legislative changes on their businesses, if they have not done so already, to ensure that they become familiar with and make changes to comply with the new Act.

Provisional Value Regime

One of the fundamental changes under the Act is the introduction of the Provisional Value Regime.

The regime will permit importers to declare a provisional value for goods in specific circumstances and declare a final value later.

There is certain criteria to register for the regime; however, broadly, those who make transfer pricing adjustments or make royalty payments should be eligible to register. Taxpayers should take steps to confirm eligibility.

Key points to note include:

- Preferential treatment will be given to those importers that have an advance pricing agreement with the New Zealand Inland Revenue.
- The formal mechanism will deal with transfer pricing adjustments and other adjustments to the customs value of imported goods.
- Importers not enrolled in the regime may be exposed to interest and late payment penalties if there is a change in the value of the goods.

For additional information, contact:

Ernst & Young New Zealand

Paul Smith, *Auckland*
+64 9 348 8409
paul.smith@nz.ey.com

Matthew Minnema, *Auckland*
+64 9 348 8343
matthew.minnema@nz.ey.com

Côte d'Ivoire

Special authorization on transit and re-exportation of "sensitive" goods

The Customs Director has informed service users that transit and re-exportation of certain sensitive goods by road and rail to neighboring countries are now subject to special authorization.

Goods requiring special authorization

The authorization concerns goods designated as sensitive, as listed below:

- Sugar
- Vegetable oil
- Sardines
- Tomato paste
- Milk
- Alimentary paste
- Batteries
- Loincloth (traditional garment)
- Toothpaste
- Cigarettes
- Alcoholic beverages
- Poultry
- Edible offal

Operators required to obtain authorization

This authorization requirement applies to customs brokers that are holders of transit operations approval. Companies doing business in Côte d'Ivoire must use a customs broker for all import and export operations.

How to obtain authorization

Customs brokers must send a special authorization request to the Customs Director on behalf of each client for each transit or re-exportation operation.

The customs authorities carry out a risk analysis and grant special authorizations accordingly.

This measure is in force as of 11 April 2018.

Therefore, each transit and re-exportation operation of goods as listed above by road and rail to neighboring countries is now subject to a prior special authorization by the Customs Director.

Closing thoughts

As a reminder, exceptional authorizations have been granted to economic operators under the prohibition measure on re-exportation applicable to D-25 and D-8 statements, set out in Circular n°1261 of 3 October 2005.

Because of numerous abuses that undermine fair competition and endanger the public treasury interests, the Customs Director, in Circular n°1857/MBPE/DGD of 22 May 2017, discontinued type D-25 and D-8 exceptional measures for exports by road to the neighboring countries along the seacoast. These products may now be re-exported by different means of transportation subject to special authorization.

Importers are advised to communicate with their brokers and ensure timely compliance with the new requirements.

For additional information, contact:

FFA Conseil S.A (Côte d'Ivoire)

Eric Nguessan, *Abidjan*
+225 20 21 11 15
eric.nguessan@ci.ey.com

Laetitia Monnet Obou, *Abidjan*
+225 20 21 11 15
laetitia.monnet@ci.ey.com

Roger Gbakayoro, *Abidjan*
+225 20 21 11 15
roger.gbakayoro@ci.ey.com

Alex Koffi, *Abidjan*
+225 20 21 11 15
alex.koffi@ci.ey.com

Italy

Italian Customs Agency clarifies implementing procedures regarding authorization to store energy products in third-party warehouses

On 12 April 2018, the Italian Ministry of Economy and Finance issued a Decree regarding the implementation procedures of the legal provisions on the authorization to store energy products[35] in third-party warehouses, as per Article 1, Paragraph 957, of the 2018 Budget Law (so-called "TRADERS" Authorization).

Specifically, the above Decree sets forth the rules regarding the content of the electronic authorization request.

The Italian Customs Agency's Note no. 71725 dated 27 June 2018 provides clarifications regarding the Ministerial Decree on the implementing procedures for issuing authorization to store energy products in third-party warehouses.

Content of the authorization request

Businesses that intend to store their energy products in either third-party tax warehouses or registered consignee's warehouses (auxiliary warehouses), before commencing storage operations, must submit electronically an authorization request that includes the following information:

- Name, registered office address, value-added tax (VAT) registration number, owner/legal representative's details and, in case of companies, a list of the shareholders
- Address where to receive communications or certified email address (*posta elettronica certificata*, PEC, in Italian)
- Type of energy products that will be stored, identified by the respective Harmonized Tariff Schedule (HTS) codes
- Details of the tax license of as per Article 25 of Legislative Decree 504/1995 (Excise Duties Law), if any
- Details of the authorization to operate as a registered consignee, if any
- Details of the annual fee paid for the issuance of the authorization (EUR258.23), through postal payment slip completed per instructions to be provided by the competent customs office

---

[35] The Italian excise law (Legislative Decree no. 504/1995), Article 21, Paragraph 1, lists the products that fall under the definition of "energy products" as follows:

- From Combined Nomenclature (CN) 1507 to CN 1518, if destined to be used as heating or motor fuel
- CN 2701, CN 2702 and from CN 2704 to CN 2715
- CN 2901 and CN 2902
- CN 2905.11.00, if destined to be used as heating or motor fuel
- CN 3403
- CN 3811
- CN 3817
- CN 3824.90.99, if destined to be used as heating or motor fuel

Furthermore, the applicant must also attach a declaration by the owner or the legal representative certifying that there are no reasons to deny the authorization.

The following entities must submit an application properly signed by the owner or by the legal representative of the company:

- Businesses established in Italy, to the competent customs office, according to the registered office
- Businesses established in another European Union (EU) Member State, to any customs office located in a region capital

For businesses not established in the EU, the application must be signed by the VAT representative and submitted to the competent customs office according to the fiscal domicile of the VAT representative.

Procedural aspects

The competent customs authority is responsible for verifying that submitted requests are complete. Customs may request additional information if the application appears to be incomplete.

After having verified payment of the annual fee, the customs office will issue, within 30 days from the filing of the request, the authorization for storage at the auxiliary warehouses, assigning an identification code to the authorized subject. The authorized subject must then collect the authorization at the competent customs office.

The authorization is valid for two years and allows storage in the auxiliary warehouses, for which the authorized subject obtains the consent of the operator of the tax warehouse or the registered consignee. Authorized subjects must notify the customs office, within five days, of any change in the information indicated on the application or declaration.

To continue storage beyond the two-year period of validity, a new application must be submitted at least 30 days before the deadline. Again, the operator of the tax warehouse or the registered consignee must give consent and must transmit approval electronically to the customs office. The approval must contain:

- Identification data of the business receiving the storage authorization (and the related identification code)
- The consent validity period
- Details of the energy products held in the auxiliary warehouse on behalf of the authorized person

Special provisions for businesses operating their own tax warehouse

Businesses that already hold an authorization or a license neither revoked nor suspended to operate a tax warehouse for energy products and that intend to store their products at an auxiliary warehouse are required to send a specific electronic communication to the competent customs office, at least 30 days before the start of the storage activity. They must provide a list of the energy products that will be stored at the auxiliary warehouse. The customs authorities will grant an identification code, valid for one year, within 30 days. To extend storage beyond the year of validity, it is necessary to file a new communication at least 30 days before the deadline. To proceed with storage, the operator of the tax warehouse or the registered consignee must give consent.

The Decree is in force as of 1 July 2018, but the authorization for storage of energy products in third-party warehouses is effective from 30 August 2018. Communications submitted after 31 July 2018 will be valid from the 30th day following the filing.

Businesses not operating fiscal warehouses and that intend to store their energy products in auxiliary warehouses may submit an authorization request to the customs office by filing all the documents listed above.

Accounting obligations

Authorized subjects, and those who have made the communication referred to in the previous section, must keep records of the daily quantities of energy products stored at each auxiliary warehouse. The records must be made available to the authorities as follows:

- Monthly, for businesses that obtained an authorization to store their energy products in a third party's warehouse, to the customs office that issued the authorization, by the 10th day of the month following the month referenced in the summary
- Yearly, for businesses that own their excise duties warehouse, but obtain as well an authorization for storage in a third party's warehouse, to the customs office to which the communication was sent, within the month following the year of reference

The data related to products stored in auxiliary warehouses on 30 August and 31 August 2018 must be filed together with the reporting for the month of September, in other words, by 10 October 2018.

For additional information, contact:

Studio Legale Tributario (Italy)

Nicoletta Mazzitelli, *Rome*
+39 06 8556 7323
nicoletta.mazzitelli@it.ey.com

Andrea Primerano, *Rome*
+39 06 8556 7355
andrea.primerano@it.ey.com

Stefano Pavesi, *Milan*
+39 02 8514 3646
stefano.pavesi@it.ey.com

Uganda

Uganda introduces domestic tax exemptions for developers and operators in free zones

With effect from 1 July 2018, free zone developers and operators in Uganda have the benefit of specific tax exemptions from income taxes, value-added taxes, excise duties and stamp duties, provided the prescribed conditions are satisfied.

What are free zones?

In 2014, Uganda introduced free zones when it enacted the Free Zones Act, 2014 that took effect on 1 August 2014 and later the Free Zones (General) Regulations, 2016. The laws provide for the establishment, development, management, marketing, maintenance, supervision and control of free zones.

The Free Zones Act defines a "free zone" as "a designated area where goods introduced into the designated area are generally regarded, so far as import duties are concerned, as being outside the customs territory and includes Exports Processing Zones or Free Port Zones."

This means that the goods that are introduced into the designated area, or that are manufactured there and re-exported, are not subject to customs duties. Companies operating within the free zones are also exempted from various regulations that normally apply to companies operating in Uganda.

The specific tax exemptions

Prior to 1 July 2018, the tax exemptions provided under the law for developers and operators in free zones were limited to import duties and the general exemptions that were also available to other qualifying persons outside the free zones. The general tax exemptions included:

- Income tax holiday for 10 years on exportation of finished consumer and capital goods
- Exemption from tax on income from agro-processing
- Exemption from capital gains tax on plant and machinery used in the free zones for five years and one day upon disposal
- Exemption from all taxes, levies and rates on exports from the free zones
- Exemption on personal income of a person offering technical assistance under a technical assistance agreement
- Value-added tax (VAT) exemption on selected services and supplies
- A deduction of 50% off the cost base of the property on eligible property put into service for the first time outside a radius of 50km from the boundaries of Kampala

The recent tax amendments, in effect as of 1 July 2018, made changes to the Income Tax Act, Value Added Tax Act, Excise Duty Act and Stamp Duty Act and introduced specific tax exemptions from income taxes, VAT, excise duties and

stamp duties for developers and operators in free zones. Therefore, under certain specific circumstances, the income earned and transactions carried out by free zone developers and operators will now be tax and duty exempt.

Under the Income Tax (Amendment) Act, 2018, the income of a free zone developer, whose investment is at least USD100 million, is exempt from income tax for a period of five years from the date of commencement of construction.

Similarly, the income of an operator in a free zone or other business outside the free zone, whose investment capital is at least USD 15 million in the case of a foreigner, or USD 5 million in the case of a Ugandan citizen, is exempt from income tax for five years from the date of the business commencement.

The Value Added Tax (Amendment) Act, 2018, exempts from VAT the cost of a feasibility study, design and construction, earthmoving equipment and machinery, and construction materials for a developer whose investment is at least USD100 million. The law also exempts such developer from excise duty on construction materials for development.

Furthermore, the law exempts an operator from paying VAT on the supply of services to conduct a feasibility study and design. In addition, construction materials of a factory or warehouse, locally produced raw materials for construction of a factory or a warehouse, the supply of locally produced raw materials, and inputs or machinery and equipment are exempt from VAT and excise duty, provided a number of conditions are met. These conditions are discussed below.

No stamp duty is charged on the following:

- Debenture instruments
- Imposing additional charges on a mortgaged property
- Lease of land
- Increase of share capital
- Transfer of land
- An agreement to provide services on conducting a feasibility study or developing a design for construction executed by, or on behalf of, a developer or operator, provided the prescribed conditions are satisfied

Conditions to be satisfied by free zone operators

To benefit from the VAT, excise duty and stamp duty exemptions, operators must meet the following conditions:

- A minimum investment capital of USD15 million in the case of a foreigner and USD10 million in the case of a Ugandan citizen
- The business is in the field of agro-processing, food processing, medical and household appliances, building materials, light industry, automobile manufacturing and assembly, furniture, logistics and warehousing, information technology or commercial farming
- Seventy percent of the raw materials used are sourced locally, subject to availability
- Directly employs a minimum of 60% of Ugandan citizens
- Provides for substitution of 30% of the value of imported products

Closing thoughts

The objective for establishing free zones in Uganda is to promote export-driven economic growth and development through increased exports and foreign direct investment (FDI). The developers and operators in free zones are attracted to investment-friendly environments and especially to favorable tax regimes. Therefore, the existence of import duty exemptions and the introduction of these domestic tax exemptions specific to free zone developers and operators is a much welcome initiative toward accomplishing this objective.

However, commentators note that some tax exemptions for operators may turn out to be counterproductive. For example, certain operators that derive income from agro-processing and exportation of finished consumer and capital goods may be affected negatively because the newly introduced specific income tax exemption reduces the period of time for exemption eligibility for exportation of finished consumer goods and capital goods from 10 years to 5 years. Similarly, under the general exemptions, there is no time limit for the exemption on income from agro-processing, but the specific exemption caps it at five years.

According to the generalia specialibus non derogant (the general does not detract from the specific) legal principle of statutory interpretation, in the case of an inconsistency between a specific and general provision of the law, the specific provision takes precedence. Thus, free zone operators will lose out on the general exemptions, which are more advantageous. Unless some of the new tax provisions are further amended in the future to deal with this inconsistency, free zone operators may continue to face this challenge.

For additional information, contact:

Ernst & Young (Uganda)

Lucy Kemigisha, *Kampala*
+256 41 434 3520
lucy.kemigisha@ug.ey.com

United Kingdom

UK Government's guidance on preparing for "no deal" on Brexit outlines indirect tax implications

On 23 August 2018, the United Kingdom (UK) Government published its first batch of technical notices setting out some of its unilateral actions and recommended steps for businesses in a "no-deal" scenario on Brexit. This scenario would be one where the UK leaves the European Union (EU) on 29 March 2019 without an agreed EU Withdrawal Agreement and without a framework in place for a future relationship between the UK and the EU. However, in such a scenario, the UK Government does expect that some agreements can still be reached with the EU given the number of interdependencies between the UK's and the EU's respective contingency plans.

This article focuses on the notices explaining how the UK Government intends to operate its customs and value-added tax (VAT) border from 29 March 2019 absent a deal. The steps announced in these notices will help reduce some friction in the event of a no-deal scenario mostly for companies that import to the UK. In particular, allowing for VAT to be dealt with in VAT returns rather than to be paid at the border will reduce cash flow impacts, particularly for smaller firms, and a selective approach to customs checks will help reduce the risk of delays and costs at the border.

While helpful, these notices can only cover some of the impact businesses face in a no-deal scenario and, of course, only cover the UK perspective. UK customs waving through a shipment will have limited effect if that shipment is stopped on the EU side and there are delays on that side. The UK Government is right to challenge the EU to reciprocate some of these arrangements to avoid the most damaging friction, not least for EU-based firms, should a deal not happen.

The notices published represent about a third of the total notices the UK Government intends to publish by the end of September. Some of the critical issues in reaching a full agreement between the UK and the EU, such as the "border" between Northern Ireland and the Republic of Ireland, are the subject of current negotiations, and, in the notices, the UK Government simply reiterates that it will be working on a solution to the Irish border issue with the EU.

Customs and trade

Customs function development

All trade between the UK and the EU will require customs declarations, as well as safety and security declarations. It is clear that businesses will need to develop and expand their customs knowledge, particularly businesses that have no experience in imports and exports outside the EU.

All current trade of goods between the EU and the UK will need to be classified as per the existing HM Revenue & Customs (HMRC) customs tariff. No immediate changes will be made to the existing commodity codes in use, but import licenses or supporting

documentation may be required. This allows businesses confidence in the requirements that need to be met and provides the ability to evaluate their existing master data against the requirements.

Businesses need to evaluate between both their customers and suppliers which Incoterms are best fit for trade, bearing in mind that these contractual decisions will now directly impact who will act as the importer or exporter along with all the requisite administration, duty costs and compliance.

The UK Government invites businesses to consider using customs special procedures that could allow relief of suspensions of duties for goods traded with the EU. These come with controls requirements and potential IT demands to be met that typically have three- to six-month lead times to be met, meaning businesses need to make those evaluations now if they want to be effective in March.

Future tariff impacts

The UK intends to continue offering unilateral preferences to developing countries and to transition all existing EU free trade agreements (EU FTAs). By omission, this means that exporters using EU FTAs may lose the preferential treatment. The most favored nation rates will be applicable for trade between the EU and the UK; however, the UK may choose to apply new duty rates that differ from the EU.

Export controls

Dual-use items primarily require no license to move between the UK and the EU currently. If the UK leaves the EU without a deal, licenses issued in the country of export would be required for trade of these goods. Existing export licenses for dual-use goods issued in the UK would no longer be valid if exporting from an EU Member State: a new EU license would be needed and vice versa if exporting from the UK using an EU license.

Other points

UK excise goods moving under the Excise Movement and Control System (EMCS) will now only be allowed for domestic movements. Businesses importing from the EU will need to make use of a registered consignor to enter goods into suspension and subsequently EMCS in a no-deal scenario.

For businesses producing and processing organic foods, UK businesses would only be able to export to the EU if they were certified by an organic control body recognized and approved by the EU to operate in the UK; however, UK control bodies are not permitted to make these applications until the UK becomes a "third country," and approval can take up to nine months. The UK Government will work with the EU for a solution.

The UK Government has applied to rejoin the Common Transit Convention, which will facilitate cross-border movement and which will be a critical tool, especially with goods movements to Ireland.

In respect of trade remedies, the UK will review all existing measures applied by the EU and is developing a new system called the Trade Remedies Authority for businesses to raise complaints for investigation after Brexit.

VAT

The UK Government has confirmed the continuation of a VAT system after the UK leaves the EU and that the VAT rules relating to UK domestic transactions will continue to apply to businesses as they do now. The technical notice highlights the VAT changes that businesses will need to prepare for when:

- Importing goods from the EU
- Exporting goods to the EU
- Supplying services to the EU

UK businesses importing goods from the EU

Accounting for import VAT on goods imported into the UK

Postponed accounting will be introduced for import VAT on goods brought into the UK. This means that UK VAT-registered businesses that import goods to the UK will be able to account for import VAT on their VAT return, rather than paying import VAT on or soon after the time that the goods arrive at the UK border. This will result in

significant cash flow savings for business as the import VAT will be offset in the VAT return, rather than being paid and then recovered.

Postponed accounting will apply to imports both from the EU and non-EU countries. Customs declarations and the payment of any other duties will still be required.

VAT on goods entering the UK as parcels sent by overseas businesses

If the UK leaves the EU without an agreement, then Low Value Consignment Relief will no longer apply to any parcels arriving in the UK, and all goods entering the UK as parcels sent by overseas businesses will be liable for VAT (unless they are already relieved from VAT under domestic rules).

For parcels valued up to and including GBP135, a technology-based solution will allow VAT to be collected from the overseas business selling the goods into the UK. Overseas businesses will charge VAT at the point of purchase and will be expected to register with HMRC and account for VAT. On goods worth more than GBP135 sent as parcels, VAT will continue to be collected from UK recipients in line with current procedures for parcels from non-EU countries.

VAT on vehicles imported into the UK

Businesses should continue to notify HMRC about vehicles brought into the UK from abroad, as they do now, using the Notification of Vehicle Arrivals (NOVA) system, which will continue to be used for this purpose.

Import VAT will be due on vehicles brought into the UK from EU Member States. Certain relief will also be available as with current imports of vehicles from non-EU countries. Businesses will need to continue to use NOVA to verify that VAT is correctly paid on imported vehicles.

UK businesses exporting goods to the EU

UK businesses exporting goods to EU consumers

Distance selling arrangements will no longer apply to UK businesses, and UK businesses will be able to zero rate sales of goods to EU consumers. EU Member States will treat goods entering from the UK as imports with associated import VAT and customs duties due when the goods arrive into the EU.

UK businesses exporting goods to EU businesses

VAT-registered UK businesses will continue to be able to zero rate sales of goods to EU businesses. EC sales lists will not be required. There will be a need for evidence to prove that goods have left the UK, to support the zero rating of the supply.

UK businesses supplying services into the EU

"Place of supply" rules for UK businesses supplying services into the EU

The main VAT place of supply rules will remain the same for UK businesses. The rules around "place of supply" will continue to apply in broadly the same way that they do now, subject to the points below.

For UK businesses supplying **digital services to nonbusiness customers** in the EU, the place of supply will continue to be where the customer resides. VAT on services will be due in the EU Member State where the customer is resident.

For UK businesses supplying **insurance and financial services**, input VAT deduction rules for financial services supplied to the EU may be changed. We will provide an update once more information is available.

Other points

UK businesses selling their own goods in an EU Member State to customers in that country will be required to register for VAT in that EU Member State where sales are made in order to account for the VAT due in that country.

The technical notice recognizes that the impact on the Tour Operators Margin Scheme is still not clear. HMRC has been engaging with the travel industry and will continue to work with businesses to minimize any impact.

Businesses that sell digital services to consumers in the EU will be able to register for the Mini One Stop Shop (MOSS) non-union scheme. Businesses that want to continue to use the MOSS system will need to register for the VAT MOSS non-union scheme in an EU Member State.

This can only be done after the date the UK leaves the EU. The non-union MOSS scheme requires businesses to register by the 10th day of the month following a sale.

UK businesses will need to use the existing VAT refund processes for non-EU businesses. This varies across the EU, and businesses will need to make themselves aware of the processes in the individual countries where they incur costs and want to claim a refund.

UK businesses will be able to continue to use the EU VAT number validation service to check the validity of EU business VAT registration numbers, but UK registration numbers will not be a part of it. HMRC is developing a service so that UK VAT numbers can continue to be validated.

Next steps

The UK Government has repeated that it believes a no-deal scenario remains unlikely given the mutual interests of the UK and the EU in securing a negotiated outcome. Negotiations covering both the future UK-EU relationship and remaining points on the Withdrawal Agreement will continue on a regular basis in the coming weeks. The next meeting of the EU Council is set for 17 to 18 October 2018, and the UK's technical notices and any responses to them will be part of the background to the negotiations leading up to that meeting. Businesses will hope for more certainty as to the way forward to emerge from these negotiations, preferably at the earliest opportunity.

For additional information, contact:

Ernst & Young LLP (United Kingdom)

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

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

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

Onelia Angelosanto, *Manchester*
+44 16 1234 0508
onelia.angelosanto@uk.ey.com

Jamie Ratcliffe, *London*
+44 12 1535 2255
jratcliffe@uk.ey.com

Andy Bradford, *London*
+44 20 7951 4963
abradford@uk.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY Global Trade practices

We bring you a global perspective on Global Trade. EY Global Trade professionals can help you develop strategies to manage your costs, speed your supply chain and reduce the risks of global trade. We can help to increase trade compliance, improve import and export operations, reduce customs and excise duties and enhance supply chain security. We help you to address the challenges of doing business in today's global environment to help your business achieve its potential. It's how EY makes a difference.

TradeWatch is a quarterly newsletter prepared by EY's Global Trade groups. For additional information, please contact your local Global Trade professional.

EYG no. 011486-18Gbl
BSC no. 1809-2860943

ED None

ey.com

TradeWatch contacts:

EY Americas

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

EY Asia-Pacific

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

EY EMEIA

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

TradeWatch Editor

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