

# TradeWatch

Summer 2019

## EY Global Trade

Quarterly update



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Insights

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# Global trade is making headlines on a daily basis

Watch this short video to find out why! It was produced by the Tax Insights team as part of the series featuring EY leaders discussing the Future of Tax. It features three Global Trade partners, Armando Beteta, Dalton Albrecht and Yoichi Ohira talking about trade disruption and its impact on global supply chains, and is available on the [ey.com Global Trade page](#) (under *Our latest thinking*) to share with clients and contacts. ■



# What trade executives are currently thinking about global trade disruption

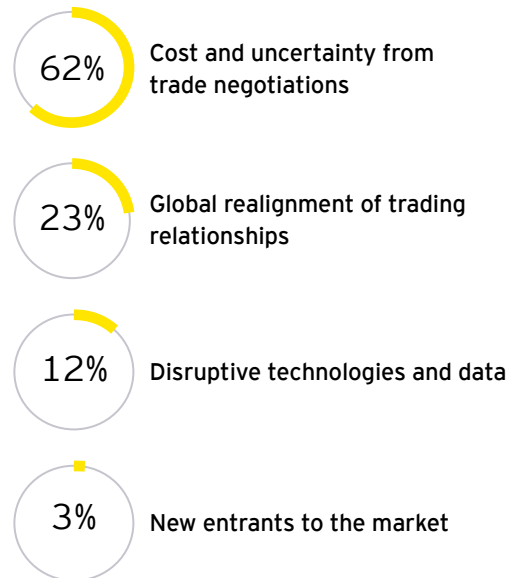
During a recent webcast, we surveyed more than 2,300 participants about global trade disruption, which continues to dominate news headlines around the world as disruptive actions develop almost daily. More than 60% of respondents are concerned about the cost and uncertainty arising from trade negotiations, while the realignment of global trading relationships was also highlighted as a worry.

Tensions are high among many of the world's largest economies and trading partners as they try to find a new trade equilibrium. The current contentious state between the US and China is having a large impact on more than 50% of executives surveyed, and other trade actions around the world are affecting executives as well.

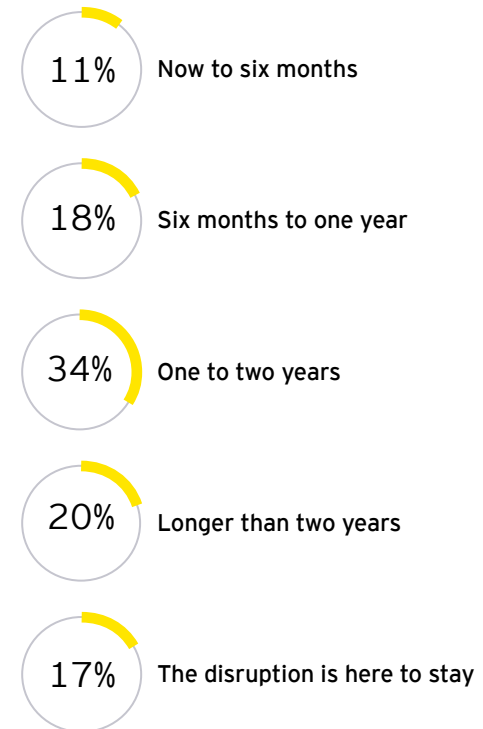
How long is this trade disruption going to last? It seems likely that companies will need to buckle up for an extended period of global trade uncertainty. Almost three-quarters of respondents see the disruption continuing for the foreseeable future, while nearly 20% think the disruption is here to stay. The longer this goes on, the more important it becomes to plan for now and into the future as more than half of our respondents have already done. The time to act is now.

**For more information, please watch the [webcast replay](#).**

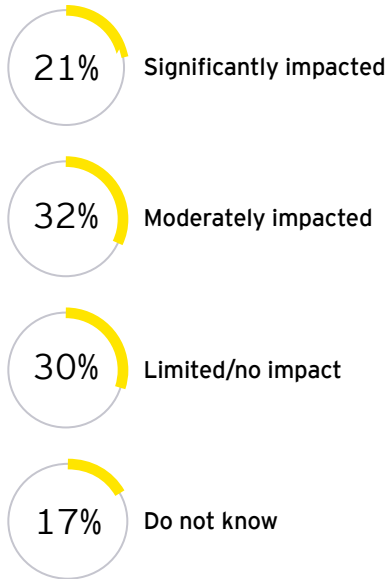
## What element of trade disruption is keeping you up at night?



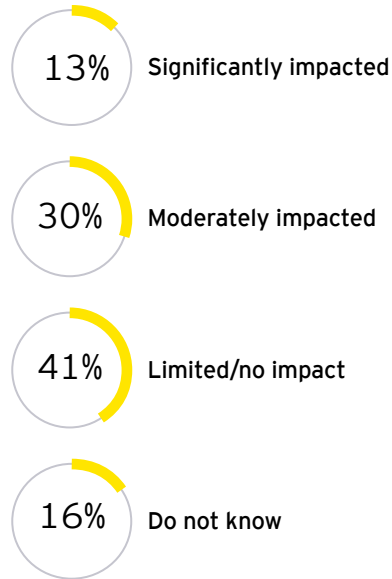
## How long do you think this period of trade disruption will last?



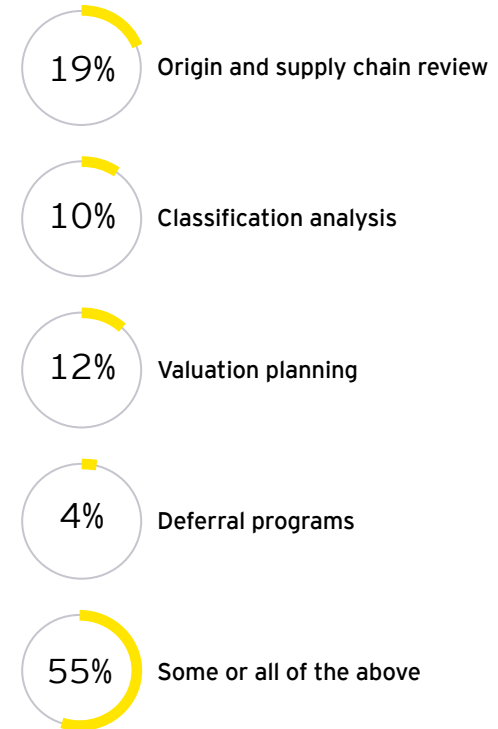
**How much impact is your company experiencing from the China-US trade disruption?**



**How much impact is your company experiencing from the rest of world, non-China/US, trade disruption (Brexit, 232 Auto, EU)?**



**What strategies have you employed to date?**



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# Technical Committee on Customs Valuation approves advisory opinion on flash sales



The Technical Committee on Customs Valuation (TCCV) has approved a new Advisory Opinion discussing the appropriate customs value of items imported pursuant to a flash sale. It will be released following approval by the World Customs Organization (WCO) Council in June.

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

The Advisory Opinion defines a flash sale as a “promotional sale offered in the short term and at highly discounted prices to attract potential purchasers.” Flash sales can occur through traditional sales channels or through e-commerce, but flash sales resulting in imports are often e-commerce transactions, with a seller offering an on-line sale for a limited period (e.g., the next hour) or for a specified number of purchasers (e.g., the first 50 buyers).

Two issues were addressed in the Advisory Opinion:

1. Can the importer declare the flash sale price as a valid transaction value?
2. If so, in subsequent importations of identical or similar products which are not themselves eligible for transaction value, can the flash sale value be used as a benchmark value for the subsequent imports?

The preferred method of customs valuation is Transaction Value, defined in Article 1 of the Valuation Agreement as “the price actually paid or payable for the goods when sold for export to the country of importation.” The Advisory Opinion makes clear that a flash sale purchase by a buyer unrelated to the seller constitutes a transaction value. It should serve as the basis for customs valuation, as long as the conditions for a valid transaction value specified in Article 1.1 of the Valuation Agreement are met (e.g., no restrictions on disposition by the buyer, the purchase is not subject to consideration that cannot be valued).

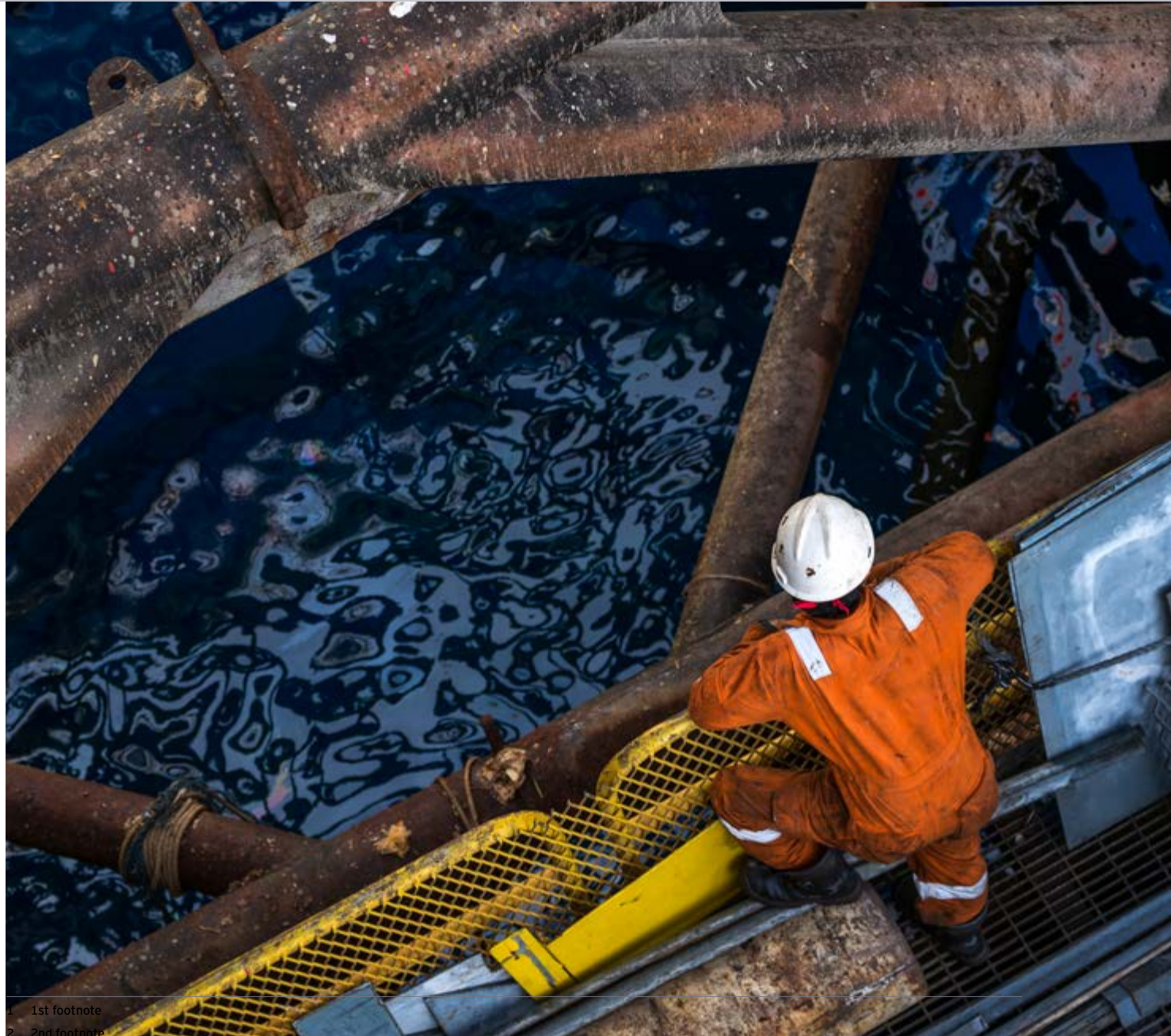
The second issue deals with if this transaction value can serve as a valid comparison for subsequent imports of the same or similar items that are not eligible for transaction value, typically when a single party is both the importer and the exporter

so that there is no sale for export to the country of importation. Under the hierarchy established by the Valuation Agreement, the next methods of valuing products when there is not a valid transaction value are Transaction Value of Identical Merchandise (defined in Article 2 of the Valuation Agreement) and Transaction Value of Similar Merchandise (defined in Article 3 of the Valuation Agreement). Articles 2 and 3 require that the benchmark transaction value, in this case the flash sale value, is for goods sold for export to the same country of importation, exported at about the same time as the identical or similar goods being valued, and subject to the same commercial practices and market conditions.

While the Advisory Opinion does not foreclose the possibility that a flash sale could be a valid benchmark, it concludes that “it is unlikely that the commercial practices and market conditions prevailing under flash sales would exist in situations other than flash sales.” Consequently, the flash sale price could not be used for a wholesale or bulk importation of products like those sold in a flash sale.

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1st footnote

2nd footnote



# WTO rules in favor of Russia in Russia-Ukraine transit dispute: potential impact on section 232 disputes



On 5 April 2019, a World Trade Organization (WTO) Dispute Settlement Panel (the Panel) concluded Russia properly invoked a national security exception under the 1994 Global Agreement on Tariffs and Trade (GATT) during 2016.<sup>1</sup> Russia invoked the GATT Article XXI(b)(iii) exception in response to Ukraine's claim that certain Russian travel bans and restrictions denying traffic in transit by road or rail across Russia to other countries were contrary to its WTO commitments.<sup>2</sup>

Notably, while the Panel upheld Russia's use of the national security exceptions, it disagreed with Russia's position that the Panel lacked jurisdiction to review whether an action was in fact taken for national security. Russia's position was supported by the US and nine other member countries.<sup>3</sup>

In evaluating the language of the Article XXI national security exceptions, the Panel noted that members may have varying perceptions as to what

- <sup>1</sup> See Article XXI(b)(iii) of the 1994 General Agreement on Tariffs and Trade (GATT), Apr. 15, 1994.
- <sup>2</sup> These measures included the 2016 Belarus Transit Requirements and the 2016 Transit Bans on Non-Zero Duty and Resolution No. 778 Goods, which restrict transit by road and rail from Ukraine destined for Kazakhstan or the Kyrgyz Republic from transiting directly across the Ukraine-Russia border, requiring traffic to detour through Belarus, and meet additional requirements at specific control points, and prohibit such transit for certain classes of goods subject to authorized exceptions.
- <sup>3</sup> Members filing third-party arguments included Australia, Brazil, Canada, China, The European Union, Japan, Moldova, Singapore, Turkey and the US.

circumstances “it considers” might give rise to a threat to its “essential security interest.” Yet, the Panel concluded Russia’s use of this national security exception is subject to Panel review as to whether the action was taken in “good faith,” rather than to circumvent international obligations.

This decision may significantly impact disputes currently pending with the WTO Dispute Settlement Body, including complaints challenging US tariffs implemented on certain steel and aluminum imports pursuant to Section 232 of the US Trade Expansion Act of 1962 (Section 232). Ukraine and Russia may appeal within 60 days following the Panel decision, which is quickly approaching.

### Ukraine-Russia dispute

Ukraine took issue with certain Russian bans and restrictions as denying traffic in transit by road or rail across Russia and destined for Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan. On 14 September 2016, Ukraine requested WTO dispute settlement consultations with Russia and later requested a panel, which was ultimately composed by the WTO Director-General on 6 June 2017.

Ukraine alleged the measures violated Russia’s commitments under Article V of GATT, which requires Member States to guarantee freedom of movement; Article X of the GATT, which requires publication of trade-affecting measures; as well as related commitments in Russia’s WTO Accession Protocol.

### GATT Article XXI security exceptions

In response to Ukraine’s claims, Russia invoked a security exception of Article XXI(b)(iii) of the GATT, which provides members may suspend normal trading obligations where certain national security interests exist. The security exceptions provided by Article XXI include the following:

“Nothing in this Agreement shall be construed ... (b) to prevent any contracting party from taking any action *which it considers* necessary for the protection of its essential security interests

1. relating to fissionable materials or the materials from which they are derived
2. relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for supplying a military establishment
3. taken in time of war *or other emergency in international relations ...*”<sup>4</sup>

### Justiciability of the security exceptions

Russian representatives argued that the Panel lacked jurisdiction to hear the case and asked that the Panel rule in its favor “without engaging in any further exercise, given that this panel lacks jurisdiction to evaluate measures taken.”<sup>5</sup> The US was among 10 countries that supported Russia’s view that the dispute settlement body lacks authority to review member country claims made under Article XXI.

In its submission, the US maintained the right to invoke the article is an “inherent right” and that the language “which it considers necessary for the protection of its essential security interests” is “self-judging.” Accordingly, the US argued there are no legal criteria by which a Member’s consideration of its essential security interests can be judged, and therefore such claims were “non-justiciable.”

The Panel disagreed, finding it has jurisdiction to determine whether Article XXI(b)(iii) requirements are satisfied. In its analysis, the Panel reviewed the negotiating history of the text, including early drafts submitted by the US and related US comments, and noted the time in which the text was drafted, just following the Second World War. The Panel reasoned, “[it] would be entirely contrary to the security and predictability of the multilateral trading system” to subject the existence of a member’s obligations to unilateral will of that member.

### Panel approves Russia’s national security claim

Despite agreeing with Ukraine’s argument that it could review Russia’s national security claim, the Panel ultimately validated Russia’s use of the national security exception.

<sup>4</sup> GATT, Article XXI. Other security exceptions provided by Article XXI relate to disclosure of information it considers contrary to its essential security interests and the prevention of actions taken in pursuance of United Nations Charter obligations.

<sup>5</sup> Panel Report, *Russia – measures concerning traffic in transit*, WTO Doc. WT/DS512/R

First, the Panel determined from the evidence before it that Russia's actions were objectively "taken in time of" an "emergency in international relations" under Article XXI(b)(iii). The Panel found evidence that Russia-Ukraine relations were a matter of international concern between March 2014 and the end of 2016, and noted the UN General Assembly recognition of an "armed conflict" by December 2016. Further evidence of the emergency included international sanctions imposed by various countries since 2014 regarding the conflict.

Next, the Panel found that "essential security interests" generally referred to interests relating to the quintessential functions of the state and could vary with changing circumstances depending on the situation and perceptions of the state in question. The Panel held it should generally be left to each Member to define what "it considers" to be necessary to protect its essential security interests. However, the Panel explained this exercise is limited by the obligation to act in "good faith," which is a principle of international law, and reviewable by the Panel.

The Panel explained this "good faith" obligation requires that Members not use the exceptions in Article XXI to circumvent their obligations under the GATT, and gave the example of a country who would "simply re-label trade interests that it had agreed to protect and promote within the [multilateral trading] system, as 'essential security interests,' falling outside the reach of that system."

<sup>6</sup> WTO complaints filed by Qatar are DSB docket numbers DS526, DS527, and DS528.

<sup>7</sup> WTO complaints filed against the US include DSB docket numbers DS544, DS548, DS549, DS550, DS551, DS552, DS554, DS556 and DS564 (US – Steel and Aluminum Products).



The Panel explained members' obligation to interpret and apply Article XXI(b)(iii) in "good faith" meant that WTO panels may review the following:

- ▶ whether there was any evidence to suggest that the Member's designation of its essential security interests was not made in good faith
- ▶ whether the challenged measures were "not implausible" as measures to protect those essential security interests

In this instance, the Panel did not find evidence Russia lacked "good faith" in the designation of its essential security interests, finding the 2014 emergency was very close to the "hard core" of war or armed conflict, and determined the challenged transit bans and restrictions were not "so remote from, or unrelated to, the 2014 emergency, that it

is implausible" Russia implemented the measures to protect its essential security interests arising from that emergency.

### **Looking ahead at the WTO; possible implications for US Section 232 measures**

The WTO's Dispute Settlement Body is scheduled to hear two sets of cases that hinge on national security claims. The United Arab Emirates, Bahrain and Saudi Arabia have each relied on national security exceptions in response to a petition filed by Qatar.<sup>6</sup> The US has also cited national security exceptions as the basis for trade measures imposed on certain steel and aluminum imports, in response to petitions filed by nine WTO Members (i.e., China, the European Union (EU), Canada, India, Mexico, Norway, Russia, Switzerland and Turkey).<sup>7</sup>

The US tariffs were implemented under Section 232 of the US Trade Act of 1962, a US law that allows the President to take trade actions to safeguard US national security.<sup>8</sup> Notably, US law takes a more expansive view of national security interests, and provides that, when considering action under Section 232, the President shall, “recognize the close relation of the economic welfare of the Nation to our national security, and shall take into consideration the impact of foreign competition on the economic welfare of individual domestic industries; and any substantial unemployment, decrease in revenues of government, loss of skills or investment, or other serious effects resulting from the displacement of any domestic products by excessive imports shall be considered.”<sup>9</sup>

In contrast to the US law consideration of economic welfare, the WTO Panel specifically praised Members for historically “separating serious security-related conflicts from economic and trade disputes,” and, in most cases, invoking the article only in “situations of armed conflict and acute international crisis, where heightened tensions could lead to armed conflict, rather than protectionism under the guise of a security issue.” In its use of Section 232, the US has incorporated economic interests into its case for national security threats. The Panel decision subjects the US determination of whether such actions are necessary to protect its “essential security interests” in the time of “emergency in international relations” to a “good faith” review as discussed above.

With this report, the WTO sets forth a framework for review of Member actions taken pursuant to the national security exceptions and increases its relevancy in a time where the WTO may be viewed as under siege. Additional claims may be expected against the US for existing and potential Section 232 tariffs on automobiles and automobile parts, as well as uranium ore. While companies must continue to operate in the current constructs, the WTO, with its jurisdictional finding, has secured its role in future national security-related disputes. While the WTO process to resolve disputes may take months or even years, businesses that may be impacted by existing or potential trade measures based on national security claims should keep apprised of WTO developments, as a negative ruling may impact US trade policy. ■



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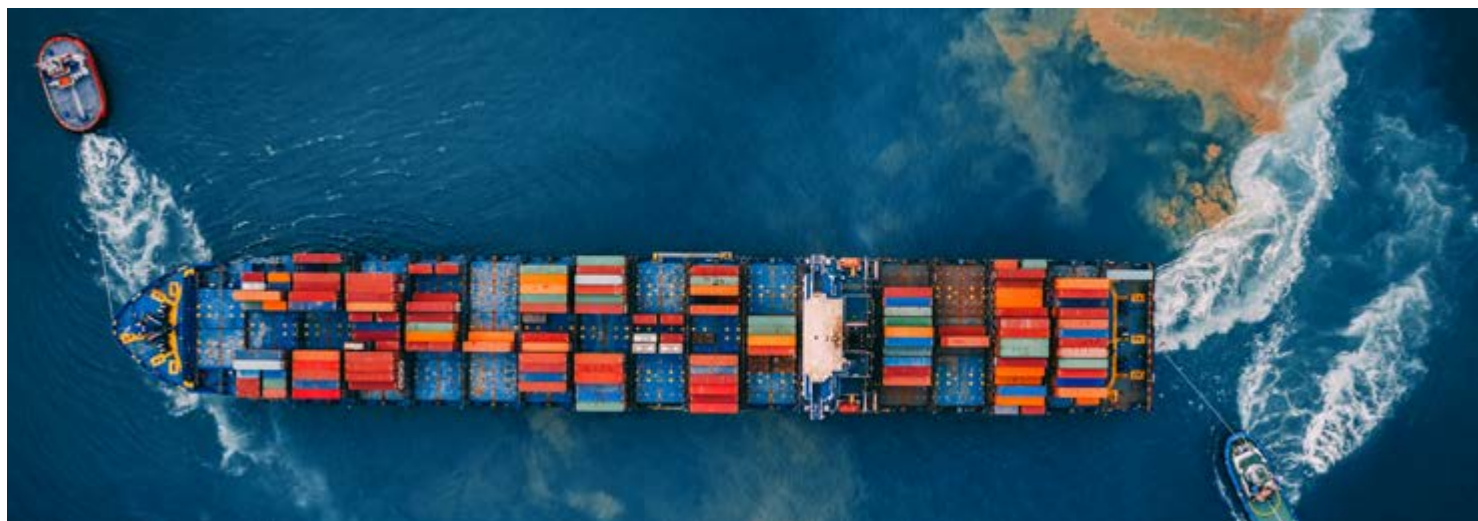
<sup>8</sup> 19 USC § 1862.

<sup>9</sup> Subsection (d) of Section 232 of the US Trade Act of 1962

## Trade and customs developments in Central America

The first half of 2019 has been very active in the fields of trade, customs and indirect taxes in Central America. During 2018, the countries of Costa Rica, El Salvador, Honduras, Nicaragua and Panama signed the Free Trade Agreement with Korea, and Costa Rica ratified the treaty this past March 2019. This agreement signifies a step toward free trade with Asia, and it supports the regional efforts to create better economic opportunities in the commercial field. Some of the products that the region exports, such as sugar, coffee, fruits, agricultural and fish will be exported with zero duties. And on the other hand, Korea's imports such as vehicles, machinery and cell phones will enjoy free trade when imported into Central America. It's an opportunity for the region but also a challenge, especially in investment, where an effort is needed to attract foreign direct investment from Korea into Central America. But it is also a chance for sectors such as technology, telecommunications and innovation to be further developed by the countries with the experience of Korea.

The WTO's Trade Facilitation Agreement is also being implemented in all the countries in the region, and it should bring important progress that companies have been witnessing, for example, the countries have opened the possibility of anticipated declarations with the purpose of expediting customs processes.



Also, it is important to remember that there is a Central American Integration System, that was established on 13 December 1991, by the signing of the Protocol to the Charter of the Organization of Central American States (ODECA) or Tegucigalpa Protocol, which amended the Charter of ODECA, signed in Panama on 12 December 1962, and formally came into operation on 1 February 1993. This integration process includes steps and time frames for the complete integration of electronic systems and mutual recognition in Central America. The process aims to establish a Central American Common Market in all areas of integration. So far,

there are 99% of duties harmonized in Central America, and technical requirements and sanitary permits are in the process of harmonization.

As a part of this integration, the Unique Customs Declaration (DUCA) entered into force in May 2019 in the six countries. While the DUCA networks are still in process, it is certainly a trade facilitation measure having a harmonized (one-for-all) system applicable to all the customs computerized transmissions.

Also, the FYDUCA (Invoice and Unique Central American Declaration) is already in place for

Guatemala and Honduras (as of last year) and it will be in force in El Salvador soon. The FYDUCA is an electronic invoice transmitted between users in both countries, eliminating the import/export concepts and transforming the transaction into a sale. The FYDUCA is applicable to almost 70% of trade between both countries, basically to all the products that do not need a sanitary permit and that are currently in free trade. One of the problems that users have encountered is that the FYDUCA does not have the system option of third-country invoicing, so the authorities are currently in conversations with the private sector to be able to implement this option in the electronic structure.

With both developments, it is important to consider that the TIC (Technology System for Customs Control), SAT (Tax Administration Intendency), DUA (Unique Customs Declaration) and other systems are no longer in place and companies should use the new DUCA. While these are positive developments

aimed at trade facilitation, companies and especially customs brokers are facing challenges to adapt to new electronic networks.

As for customs documentation in Central America, it is very standard, where all the imports must be transmitted by a DUCA, along with the value declaration, invoice and BL. In cases where a trade preference is applied, then an origin certificate should also be attached to the import.

Table 1 below shows FTAs signed by Central American countries, where each FTA states the form of the origin certificate that should be presented.

As for some indirect tax changes, it is important to consider that Costa Rica approved the fiscal plan, with the IVA entering into force in July 2019, applicable to both goods and services, along with an integral tax reform in other areas. Nicaragua has applied specific taxes to some industries, including,

for example, beverages that are imported into Nicaragua, which now have a specific tax that is calculated like that of alcohol. Panama enacted the OECD's guidelines applicable to its special zones.

In summary, this region's trade openness, wide range of FTAs and duty preferences represents an interesting option as a hub for exports into the US or other parts of Latin America. It still faces important challenges, and authorities are working toward better connectivity, digitalization and integration, so more measures are expected in these areas. ■

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Table 1: Free trade agreements in Central America

Jurisdiction	USA	EU	Canada	CARICOM	Chile	China (mainland)	Singapore	Colombia	Mexico	Panama	Peru	DR	Taiwan	Panama	EFTA	CACM
Guatemala																
Honduras																
El Salvador																
Nicaragua																
Costa Rica																
Panama						In negotiation										

Key:  = FTA in existence

# US Customs and Border Protection updates C-TPAT Minimum-Security Criteria



## Background

The Customs-Trade Partnership Against Terrorism (C-TPAT) program was introduced in November of 2001 and marked a concerted effort between US Customs and Border Protection (CBP) and the trade community to strengthen and protect America's supply chains in the wake of the events of 11 September. A voluntary program, C-TPAT is part of CBP's multi-layered strategy for cargo security enforcement. The program introduced the Minimum-Security Criteria (MSC) that members must maintain to ensure adherence to the highest levels of security and cooperation across the entire supply chain – from origin to destination. In exchange for compliance, C-TPAT affords certain benefits for trade partners, including reduced examination rates and access to the Free and Secure Trade (FAST) lanes; among others.<sup>1</sup> Since its inception, the program has grown to over 11,500 members and accounts for over 54% of US<sup>2</sup> import value, becoming a pillar of the CBP security infrastructure for the global trade community. After over two and half years of collaboration with the trade community, CBP finalized its review and updated the C-TPAT program's MSC on 3 May 2019.<sup>3</sup> C-TPAT Members

1 USTR Special 301 Report (2019), available at [https://ustr.gov/sites/default/files/2019\\_Special\\_301\\_Report.pdf](https://ustr.gov/sites/default/files/2019_Special_301_Report.pdf).

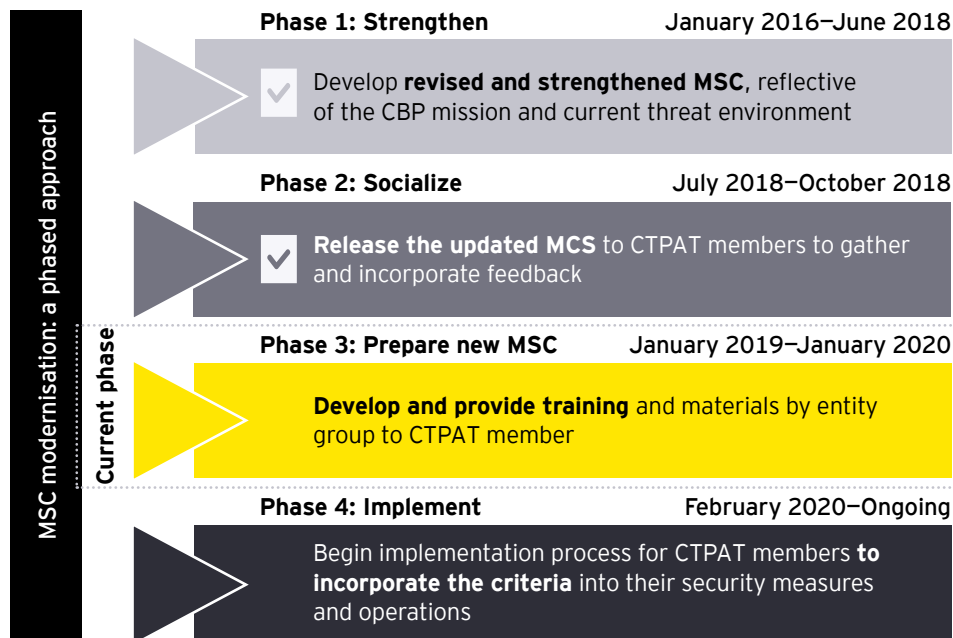
2 19 U.S.C. § 2242.

3 <https://www.cbp.gov/newsroom/national-media-release/cbp-s-customs-trade-partnership-against-terrorism-finalized-update>

are expected to study, understand and prepare for implementation of the new criteria throughout the remainder of 2019. Validations will begin in early 2020 to enforce the newly established MSC criteria.

**Modernization of (MSC)**

Complexity within global supply chains has increased exponentially over the last decade and half, caused in part by a rapid growth of trade volumes – US imports alone rose 88% between 2002 and 2016.<sup>4</sup> This boom has prompted new and substantiated concerns. Risk of data breaches and cyberattacks have brought to the fore a pressing need for comprehensive cybersecurity reform and improved security technology. All the while, vulnerabilities and threats to agricultural supply chains and continued concerns around trade-based money laundering require review and effective solutions. Over the last few years, CBP has worked closely with C-TPAT members, along with the Commercial Customs Operations Advisory Committee (COAC) Working Group to build on the existing security framework to address these concerns.



In 2016, CBP and the Working Group introduced a 4-phase modernization timeline with overarching guiding principles designed to drive standardization and adoption of improvements to the C-TPAT program.

To date, phases one and two have concluded (developing a revised and strengthened MSC, and releasing the new MSC guidelines to solicit C-TPAT member feedback for incorporation into the final program structure, respectively). The third and current stage of adoption, which focuses on developing and providing training and materials by entity group to C-TPAT members, began in January 2019 and will run until January 2020. Implementation, the fourth and final phase, is scheduled for February 2020 and will formally mark the incorporation of the agreed upon criteria into standard security operations and procedures.

**Structural changes**

The comprehensive approach to the new MSC outlines new requirements – “musts” – and recommendations – “shoulds” – in the areas of:

- ▶ Cybersecurity
- ▶ Protecting the supply chain from agricultural contaminants
- ▶ Prevention of trade-based money laundering and terrorist financing
- ▶ Use of security technology including cameras and intrusion alarms

<sup>4</sup> CBP, Minimum Security Criteria Update, July 2018



Based on the feedback provided from key C-TPAT trade community stakeholders and the Working Group, CBP has added new and crucial criteria to the C-TPAT program MSC framework to help address these prevalent and evolving security threats.<sup>5</sup> These new criteria are:

	Must	Should
<b>Security vision and responsibility</b>	<p>Integration of a written multi-level review/assessment process, which includes a system of checks and balances, and accountability,</p> <p>A C-TPAT Point(s) of Contact (POC) must be assigned and provide regular updates regarding the progress of outcomes of any audits, exercises and validations.</p>	<p>Members are encouraged to publicize their commitment to supply chain security and the C-TPAT program and incorporate representatives from all the relevant departments into a cross-functional Supply Chain Security Program.</p>
<b>Cybersecurity</b>	<p>Establish comprehensive written cybersecurity policies and procedures to protect information technology (IT) systems. The written IT policy, at a minimum, must cover all the individual cybersecurity criteria.</p> <p>Installation of sufficient software/hardware protection from malware (viruses, spyware, worms, Trojans, etc.) and internal/external intrusion (firewalls) in Members' computer systems. Members must ensure that their security software is current and receives regular security updates. Members must have policies and procedures to prevent attacks via social engineering. If a data breach occurs or other unseen event results in the loss of data and/or equipment, procedures must include the recovery (or replacement) of IT systems and/or data.</p> <p>Members utilizing network systems must regularly test the security of their IT infrastructure. If vulnerabilities are found, corrective actions must be implemented as soon as is feasible.</p> <p>Cybersecurity policies and procedures must be reviewed and updated annually, or more frequently, as risk or circumstances dictate.</p> <p>Members that allow their users to connect remotely to a network must employ secure technologies, such as virtual private networks (VPNs), to allow employees to securely access the company's intranet when located outside of the office. Members must also have procedures designed to secure remote access from unauthorized users.</p> <p>All media, hardware, or other IT equipment must be accounted for through regular inventories. When disposed, they must be properly sanitized and/or destroyed in accordance with the National Institute of Standards and Technology (NIST) Guidelines for Media Sanitization or other appropriate industry guidelines.</p>	<p>Cybersecurity policies should address how information on cybersecurity threats is shared with the Government and other business partners.</p> <p>Cybersecurity policies and procedures should include measures to prevent the use of counterfeit or improperly licensed technological products.</p> <p>Data should be backed up once a week or as appropriate. All sensitive and confidential data should be stored in an encrypted format. Media used to store backups should preferably be stored at a facility offsite.</p>
<b>Agricultural security</b>	<p>Members must have written procedures designed to prevent pest contamination and must include procedures for compliance with Wood Packaging Materials (WPM) regulations. Pest prevention measures must be adhered to throughout the supply chain. Measures regarding WPM must meet the International Plant Protection Convention's (IPPC) International Standards for Phytosanitary Measures No. 15 (ISPM 15).</p>	
<b>Money laundering and terrorist funding</b>	<p>Members must have a written, risk based process for screening new business partners and for monitoring current partners. Thorough vetting must take place and include financial soundness checks, verification of company address and duration of time in business and business phone numbers. Online research of the company should be conducted and business references should be checked.</p>	

<sup>5</sup> Based on stated aims, the COAC Working Group established three overarching focus areas—Corporate Security, People and Physical Security, and Transportation Security, to encompass 12 criteria subcategories (Table 1). Three of the 12 categories are new, while actions were taken to review and strengthen the preexisting nine.

**Implications for business**

Current and prospective C-TPAT participants are encouraged to closely review their existing security programs against the new MSC and address any gaps. C-TPAT participants that are due for a validation in 2020 will be validated against the updated MSC. Participants are encouraged to review their documented policies and procedures related to the following to ensure that the procedures meet the new MSC.

- 1. C-TPAT Assessment
- 2. Cybersecurity
- 3. Pest Contamination

In addition, members are also encouraged to review their business partner selection and screening procedures to ensure that the criteria specified by the new MSC related to money laundering and terrorist funding are included.

At this stage, members are not required to update the C-TPAT Portal as a result of the MSC update. The program will provide additional guidance later this year with regards to necessary updates to be made within the C-TPAT Portal. Members should monitor the portal for guidance, notifications and updates.

**Trusted Trader Strategy**

Working in conjunction with the new MSC, C-TPAT is currently executing the 'Trusted Trader Strategy'<sup>6</sup> which will endeavor to achieve an integrated partnership between security and trade compliance initiatives, and will be built upon the improved C-TPAT program framework. The benefits for the Trusted Trader Partnership are wide-ranging and significant, including new incentives such as access to the C-TPAT Trade Compliance Portal, an ability to flag entries for reconciliation, and expedited rulings (all currently in development). Importers and exporters are encouraged to research these programs in detail to ensure an understanding of applicability within their own unique trade environments. ■

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<sup>6</sup> CBP, Trusted Trader Framework Strategy Draft, July 2016 - EB Schmelzinger - Director, C-TPAT

# Overview of recent United States Trade Representative (USTR) Section 301 Report

On 25 April 2019, the Office of the United States Trade Representative (USTR) published its annual Special 301 Report (the Report) identifying US trading partners which it considers do not provide adequate protection and enforcement of intellectual property rights (IPR), such as copyright, patents, and trademarks.<sup>1</sup> While the Report calls out countries considered having a shortfall in adequate IPR protections and enforcement, it simultaneously provides the opportunity for the US government to work collaboratively with trading partners to improve IP protection and enforcement in the areas identified in the Report.

Under US law, the USTR must designate countries with the most onerous or egregious acts, policies, or practices and whose acts, policies, or practices have the greatest adverse impact (actual or potential) on US companies and products as Priority Foreign Countries.<sup>2</sup> Priority Foreign Countries may be subject to potential trade sanctions and/or investigations.

To facilitate this process, in its Report, the USTR categorizes countries it considers do not provide adequate and effective IPR protection, or an equitable market for US individuals and businesses that rely upon such rights, into three lists: Priority

Foreign Countries, Priority Watch List, and Watch List.<sup>3</sup> While the 2019 Report did not identify any Priority Foreign Countries, 11 countries were included on the 2019 Priority Watch List, and 25 countries were included in the 2019 Watch List.<sup>4</sup>

## The USTR Special 301 Report

The annual review of global IPR protection was implemented by Congress to provide a platform to expose foreign nations and their laws that fail to protect and enforce IPR of US companies and products. Upon enactment, Congress expressed its concern that “the absence of adequate and effective protection of United States intellectual property rights, and the denial of equitable market access, seriously impede the ability of the United States persons that rely on protection of intellectual property rights to export and operate overseas, thereby harming the economic interests of the United States.”<sup>5</sup>

The Report, provided annually since 1989, is aimed at encouraging countries to open their markets to US exports of goods and services, and provide adequate and effective IPR protection and enforcement.<sup>6</sup>



- 1 USTR Special 301 Report (2019), available at [https://ustr.gov/sites/default/files/2019\\_Special\\_301\\_Report.pdf](https://ustr.gov/sites/default/files/2019_Special_301_Report.pdf).
- 2 19 U.S.C. § 2242.
- 3 2019 Priority Watch List Countries: Algeria, Argentina, Chile, China, India, Indonesia, Kuwait, Russia, Saudi Arabia, Ukraine, and Venezuela.
- 4 2019 Watch List Countries: Barbados, Bolivia, Brazil, Canada, Colombia, Costa Rica, Dominican Republic, Ecuador, Egypt, Greece, Guatemala, Jamaica, Lebanon, Mexico, Pakistan, Paraguay, Peru, Romania, Switzerland, Thailand, Turkey, Turkmenistan, the United Arab Emirates, Uzbekistan and Vietnam.
- 5 Omnibus Trade and Competitiveness Act of 1988. §1303(a)(1)(B); see also Special Rep. 100-71 at 75 (1987).
- 6 USTR 2019 Section 301 Report; see also Section 182 of the Trade Act of 1974, as amended by Omnibus Trade and Competitiveness Act of 1988, the Uruguay Round Agreements Act, Trade Facilitation and Trade Enforcement Act of 2015 (19 U.S.C. § 2242).

### **Priority Watch List and Watch List, and Out-of-Cycle Reviews**

If a country's conduct and laws are not considered as flagrant as those identified with Priority Foreign Countries then it may nonetheless be placed under the Priority Watch List. The USTR engages in bilateral discussions with such countries, with the threat that they can be moved to a Priority Foreign Country classification if their issues are not resolved.

As per the provisions of the Special 301 statute, the USTR is to develop action plans for all the identified countries on the Priority Watch List that have been on the same list for at least one year.<sup>7</sup>

Watch List countries are those with less serious IP problems but similarly face the threat of being moved to the Priority Watch List if they fail to make considerable improvements to their policies.

In addition, the USTR may conduct Special 301 Out-of-Cycle reviews which allow the USTR to address identified issues on a bilateral basis through cooperation and heightened engagement. Out-of-Cycle reviews may result in a positive or negative change in a country's status outside the typical annual 301 review period. The Administration can execute additional Reviews based on circumstances or requests from trading partners.

### **April 2019 Special 301 Report**

As mentioned, the USTR did not identify any Priority Foreign Country this year but did include a total of 36 trading partners on its Priority Watch List and Watch List.

China remained on the Priority Watch List. The Report mentions US actions taken pursuant to Section 301<sup>8</sup> and World Trade Organization (WTO) dispute settlement proceedings in response to what is termed China's "unfair" trade practices, which is stated included technology transfer requirements imposed as a condition to market access and discriminatory licensing practices.

Canada moved from the Priority Watch List to the Watch List, in part due to the agreed upon IPR provisions in the yet to be ratified US-Mexico-Canada Agreement (USMCA).<sup>9</sup>

<sup>7</sup> 19 U.S.C. § 2242.

<sup>8</sup> Section 301 of the U.S. Trade Act of 1974 (last edition March 23, 2018). (Pub. L. 93-618, 19 U.S.C. § 2411).

<sup>9</sup> 19 U.S.C. § 2416.



**Priority Watch List**

Countries on the Priority Watch List are listed below along with the corresponding key US concerns put forth in the Report. New to this year's list is Saudi Arabia while the other 10 countries appeared on the 2018 Priority Watch List as well.

Country	Rationale
<b>Algeria</b>	US continues to remain cautious of Alegria's ineffective enforcement of their current anti-piracy statutes, the inability to seek adequate judicial remedies in patent infringement cases, and Algeria's ban on the import of numerous pharmaceutical products and medical devices in favor of local products.
<b>Argentina</b>	Argentina has a considerable backlog of patent applications resulting in long delays for innovators seeking patent protection, further aggravated by the fact that La Salada in Buenos Aires remains the largest counterfeit market in Latin America and resulting in unfair competition from counterfeit sellers.
<b>Chile</b>	The US has advised to Chile to provide remedies or penalties for deliberately receiving or further distributing illegally decoded encrypted program-carrying satellite signals due to Chile's inability to deliver on IP commitments made to the US.
<b>China</b>	China's continuous placement on this list, along with the escalating trade tensions and the fact that Section 306 monitoring remains intact, indicates the US judgment on a need for structural changes within their IP laws, which the Priority Watch List details as including online piracy, trade secret theft, a high volume of counterfeit goods and obstructions to pharmaceutical innovation.
<b>India</b>	US businesses have faced ongoing IP challenges in India where American innovators find it problematic to receive and maintain their patents in India since India has constricted the transparency of information provided on state-issued pharmaceutical manufacturing licenses. In addition, India has not revised or modified copyright policies and continues to apply an obsolete trade secrets legal framework.
<b>Indonesia</b>	Indonesia's patent laws continue to raise concerns as lacking a rigid patentability criterion, local manufacturing and use requirements, and compulsory licensing.
<b>Kuwait</b>	The US conducted an Out-of-Cycle review in 2018 and 2019 that concentrated on addressing the loopholes in their copyright policies. Areas needing work include limiting the amount of work reproduced, remedies and damages, definitions, among others.
<b>Russia</b>	Russia's ongoing challenges include trademark counterfeiting, copyright infringement, and the lack of transparent procedures that govern the operations of Collective Management Organizations.
<b>Saudi Arabia</b>	Saudi Arabia is added to the list because it has not taken serious actions against blatant online piracy made available by BeautQ, an illegal pirate service.
<b>Ukraine</b>	Ukraine, first ordained on the Priority Foreign Country list in 2013, has three primary issues: a lack of a proper system in place for collecting and distributing royalties to the right holders; widespread use of unlicensed software by government agencies; and the failure to enforce a method to curb online copyright infringement.
<b>Venezuela</b>	The World Economic Forum has consistently ranked Venezuela last in IP protection laws for six consecutive years, and their IP regulations have fallen below international trade agreement standards due to the widespread use of online piracy, unauthorized camcording, and use of unlicensed software.

### Highlights from the 2019 Watch List:

The 2019 Watch List highlights current areas lacking IPR protection and enforcement. The Report indicates online and broadcast piracy remains a challenging copyright enforcement issue in many countries, several nations failed to address the evolving challenges of copyright piracy, and US innovators face global challenges against unfair commercial use and unapproved disclosure of data for pharmaceutical and agricultural products.

Notable changes to the Watch List include the following:

- ▶ Canada moved from the Priority Watch List to the Watch List this year. The USTR acknowledged the strides Canada made within their IPR regime as part of the US-Mexico-Canada Agreement (USMCA) negotiation process, where Canada addressed issues of counterfeits, inspection of goods in transit, copyright terms, among other issues. Remaining US concerns focus on pharmaceutical products IPR.
- ▶ Colombia also moved from the Priority Watch List to the Watch List this year, as a result of improvements in their copyright domain, including recent legislation that prolonged protection terms and enforced stronger measures. Positive steps taken by Columbia came to light in a 2018 Out-of-Cycle review concentrating on US-Colombia Trade Promotion Agreement enforcement.

- ▶ Paraguay returned to the Watch List after four years, based on the USTR conclusion it did not meet provisions pursuant to a Memorandum of Understanding (MOU) with the US. The USTR concluded Paraguay failed to implement proper border enforcement regulations against counterfeit and pirated goods, and instead became a major transshipment center for such items.

### Potential for trade-related implications

The 2019 Report re-emphasizes the US Administration's focus on IPR protection and highlights current countries of focus. The recent US actions under Section 301 taken in regard to certain Chinese-origin goods are rooted in the US claim of problematic Chinese policies related to IPR protection and enforcement. The 2019 Report sets forth ongoing US concerns regarding Chinese IPR policies, which may provide further context to the ongoing US-China negotiations and related developments. Businesses impacted by proposed or implemented Section 301 tariffs on certain Chinese-origin goods should take care to consider the US basis for its use of Section 301. A better understanding of the US claim may provide additional guidance when weighing options for mitigation, such as changes to sourcing or supply chain, review of transfer pricing, or implementation of a foreign trade zone.

The Report also identifies other potential "bad actors" in the area of US IPR protection and enforcement. US businesses should take steps to understand possible implications of any future actions, including tariffs, which may be taken by the US administration based on a claim of lacking IPR protection and/or enforcement against countries identified in the Report. Companies with places of manufacture and/or operation in Priority Watch List countries would be well advised monitor any ongoing negotiations and/or proposed trade-related actions.

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# Ripple effects of US Government export ban on Huawei

## Executive summary

Effective 16 May 2019, the United States (US) Department of Commerce, Bureau of Industry and Security (BIS) issued a Final Rule announcing the addition of Huawei Technologies Co Ltd. (Huawei) and 68 of its non-US affiliates to the Entity List for “activities contrary to the security interests of the US”.<sup>1</sup> Export or re-export transactions subject to the jurisdiction of the US with Huawei and its affiliates will require export licenses from BIS that will be subject to a presumption of denial and the authorization of license exceptions is limited. Items that are already in-transit to Huawei as of 16 May are subject to a “Savings Clause” and will be permitted.

The US Government’s addition of Huawei and its affiliates to the Entity List is the latest in a line of regulatory and enforcement actions against Chinese companies and increased controls around technology.

## Background

The U.S. Department of Justice charged Huawei, its Chief Financial Officer and two affiliated companies on 28 January 2019 with violating US sanctions against Iran, bank fraud and obstruction of justice.

Huawei, the world’s largest supplier of telecom equipment, is headquartered in the People’s Republic of China (PRC) and operates in 170 countries and employs 180,000 people worldwide.<sup>2</sup> It reportedly built at least 50 3G networks in 36 countries and implemented 70% of Africa’s 4G networks. Huawei, ZTE Corporation (ZTE) and other Chinese technology companies are involved in everything from new undersea internet cables and national data networks to selling millions of mobile phones on the African subcontinent. These Chinese companies are competing with other vendors for leadership in developing 5G cellular technology, with such technological advancements bringing an increase in speed and responsiveness of wireless networks and the capacity to handle more connected devices. The addition of Huawei and many of its affiliate companies to the Entity List could have wide-ranging impact because of the forthcoming ubiquity of interconnected devices, and how such extensive devices and equipment transmit information and access the 5G networks.

<sup>1</sup> See 84 FR 22961, 21 May 2019.

<sup>2</sup> <https://www.cbsnews.com/news/3-things-to-know-about-zte-and-huawei/>.

### Addition of Huawei to the Entity List

On 15 May 2019, US President Trump signed an executive order declaring a national emergency in response to threats by foreign adversaries creating and exploiting vulnerabilities in information and communication technology or services. The order prohibits the acquisition, importation, transfer, installation, dealing in or use of any information and communications technology or service by any person where the transaction poses a risk to the national security or foreign policy of the United States. All US governmental agencies were directed to take all appropriate measures within their authority to carry out the provisions of the order.<sup>3</sup>

Shortly thereafter, BIS added Huawei and 68 of its affiliates to the Entity List because the US Government found “probable cause” that Huawei acted “contrary to national security and foreign policy interests of the United States”.

Consequently, BIS now requires US exporters and foreign re-exporters to apply for a license to export, re-export, or transfer (in country) any commodity, software or technology (collectively “items”) subject to the EAR to Huawei and its affiliate entities. Items “subject to the EAR” include all items in the United States, all US-origin items wherever located, and non-US items containing more than a de minimis level of US-controlled content.<sup>4</sup> BIS imposed a “presumption of denial” on these licenses, which effectively means the license application will likely not be granted, and Huawei will not be able to procure or obtain any items subject to the EAR.



Effective 20 May 2019-19 August 2019, companies may utilize a 90-day General License that temporarily authorizes the export, re-export or transfer (in-country) of items subject to the EAR if the transaction is specifically authorized in Supplement No. 7 to part 744 – Temporary General License. The types of transactions that may be covered by the Temporary General License include:

- ▶ Continued operation of existing networks and equipment
- ▶ Support to existing handsets

- ▶ Cybersecurity research and vulnerability disclosure
- ▶ Engagement as necessary for development of 5G standards by a duly recognized standards body

A certification statement is required to be made by the exporter, re-exporter or transferor prior to making an export, re-export or transfer (in-country) pursuant to this Temporary General License. To rely on the Temporary General License, the certification statement must specify how the export, re-export or transfer (in-country) meets the scope of the Temporary General License. The certification statement must be kept for recordkeeping purposes by the exporter, re-exporter or transferor.

<sup>3</sup> See Executive Order on Securing the Information and Communications Technology and Services Supply Chain <https://www.whitehouse.gov/presidential-actions/executive-order-securing-information-communications-technology-services-supply-chain/>.

<sup>4</sup> See 15 §CFR 734.3.



### Additional US regulatory and enforcement actions against Chinese companies

1. In 2017, ZTE pleaded guilty to criminal charges and settled record civil penalties totaling USD1.4b in exchange for the U.S. Department of Commerce suspending a denial order that would have prevented US companies from doing business with ZTE, effectively crippling the company.<sup>5</sup> Subsequently, in April 2018, BIS activated the suspended denial order against ZTE, but lifted the order in July 2018 after the company agreed to pay an additional USD1b penalty (USD 400m in escrow), overhaul its leadership and install compliance monitors for a period of 10 years.<sup>6</sup>
2. In August 2018, the Trump administration tightened control of various aspects of transactions between US and Chinese companies, including signing the National Defense Authorization Act (NDAA),<sup>7</sup> which has broad implications in terms of foreign investment and trade, specifically:
  - ▶ Section 889 of the NDAA prevents executive-branch agencies from procuring or contracting for certain covered telecommunications equipment or services from companies (i.e., ZTE and Huawei) that are associated with or believed to be owned or controlled by the PRC.

- ▶ The NDAA also introduced major reforms to the Committee on Foreign Investment in the United States (CFIUS) and provided the committee with broader authority to restrict foreign investments for national security concerns. CFIUS review can now include transactions that are not “controlling” investments for US businesses involving critical technologies, critical infrastructure or “sensitive data of US citizens.”
  - ▶ CFIUS opened an investigation on the planned USD117 billion acquisition between Broadcom, a Singapore company, and US company Qualcomm, which controlled 59.6% of the USD15.3 billion market for 4G modem chips in 2017.<sup>8</sup> The deal was eventually killed by the Trump administration citing national security concerns.
3. In August 2018, BIS added 44 Chinese parties to the Entity List<sup>9</sup> for “acting contrary to the national security or foreign policy interests of the United States”.
  4. On 1 November 2018, the U.S. Department of Justice announced a China Initiative whereby it will investigate and prosecute Chinese companies for “alleged economic espionage, trade secret theft, Foreign Corrupt Practices Act (FCPA) offenses and other violations of US law”.<sup>10</sup>

### Additional export controls Impacting high-tech industries

Effective 23 May 2019, additional export controls were implemented on certain strategic items as a result of changes made to the Wassenaar Arrangement List of Dual-Use Goods. The following emerging technologies considered essential to the national security of the United States were added to the Commerce Control List (CCL):<sup>11</sup>

5. Discrete microwave transistors (a major component of wideband semiconductors)
6. Continuity of operation software
7. Post-quantum cryptography
8. Underwater transducers designed to operate as hydrophones
9. Air-launch platforms

Depending on the destination country, these items may require a license or other form of authorization for export from the US. Companies should review the newly added entries to the CCL to determine what impact, if any, these changes will have on their export control responsibilities.

<sup>5</sup>

<sup>6</sup> [id](#)

<sup>7</sup> <https://www.whitehouse.gov/briefings-statements/statement-president-donald-j-trump-h-r-5515/>.

<sup>8</sup> <https://www.reuters.com/article/us-qualcomm-tech/samsung-huawei-supply-majority-of-own-modem-chips-qualcomm-says-idUSKCN1OZ00F>.

<sup>9</sup> <https://www.federalregister.gov/documents/2018/08/01/2018-16474/addition-of-certain-entities-and-modification-of-entry-on-the-entity-list>.

<sup>10</sup> <https://www.justice.gov/opa/speech/attorney-general-jeff-sessions-announces-new-initiative-combat-chinese-economic-espionage>.

<sup>11</sup> <https://www.federalregister.gov/documents/2019/05/23/2019-10778/implementation-of-certain-new-controls-on-emerging-technologies-agreed-at-wassenaar-arrangement-2018>.

### Impacts of increased enforcement

Multinational companies need to recognize the broad and extraterritorial reach of the US export compliance regime, as well as making substantial efforts to meet the requirements.

- ▶ The action against Huawei (and previously, ZTE) will have significant ripple effects, particularly for the US semiconductor industry for whom Huawei, ZTE and China are major markets.<sup>12</sup>
- ▶ The impacts will also be felt in the US, where rural telecom services providers rely on the lower cost technology sold by Huawei.<sup>13</sup>

### Potential planning actions for companies

Any company involved in US-China trade, or operating in industries with heightened risk (e.g., telecommunications, semiconductors, technology, aerospace, defense) is encouraged to identify the potential impact of increased enforcement by the US Government and subsequently enhancing their export compliance programs to avoid potential violations. Immediate actions for such companies should include:

- ▶ Recognizing the broad and extraterritorial reach of the US export compliance regime, as well as establishing or enhancing an export compliance program that properly monitors export control and sanctions compliance requirements
- ▶ Understanding and determining the export licensing requirements for company products by determining whether products are subject to the EAR and by accurately identifying your products' export control classification number (ECCN)
- ▶ Considering whether a Temporary General License may be applied to transactions with Huawei and its affiliates, and if so, whether transactions are compliant with the relevant license conditions, certification requirements and recordkeeping requirements<sup>14</sup>
- ▶ Implementing effective software to track transactions and to restrict doing businesses with prohibited parties (i.e., restricted party/blacklist screening)
- ▶ Developing a proactive stance toward US export regulations. If found that your company has engaged in prohibited transactions, consider voluntary disclosure to BIS to demonstrate good intentions to comply with US regulations. ■

<sup>12</sup> <https://www.nytimes.com/2019/05/25/technology/huawei-rural-wireless-service.html>.

<sup>13</sup> 84 FR 23468, 22 May 2019.

<sup>14</sup>



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# The 2019 Trump trade agenda: adjusting US trade policy to the realities of the 21st century economy

In the 15 months since United States (US) President Donald Trump delivered his trade policy agenda to Congress, the President's administration has taken several high-profile executive actions to deliver his goals of transforming the state of trade and bolstering the US economy through increased manufacturing and employment. President Trump's overall trade policy presented in February of 2018 rests on five pillars, based on promoting free, fair and reciprocal trade and strongly enforcing US trade laws, as follows:

- ▶ Support for national security policy
- ▶ Strengthening the American economy
- ▶ Negotiating trade deals that work for all Americans
- ▶ Enforcing and defending US trade laws
- ▶ Strengthening the multilateral trade system

The administration updated its trade policy agenda in March 2019, informing Congress on several trade actions. The annual report included summaries on the completed matters such as the United States-Korea Free Trade Agreement (KORUS) and North American Free Trade Agreement (NAFTA) renegotiations, as well as those underway, such as initiating new trade agreement negotiations with

Japan and the European Union (EU), anticipated trade agreement negotiations with the United Kingdom (UK) following conclusion of Brexit from the EU, and continued pressures on China to address a number of findings outlined in the Section 301 of the Trade Act of 1974 report on unfair trade practices impacting the US, among others.

The 2019 agenda directly focuses the administration's efforts toward achieving major goals established when it took office. Namely, efforts to improve conditions for American workers, policies and actions to increase and enhance enforcement of US trade laws, and to continue to promote initiatives and policies that sustain and encourage US economic growth.

The report asserts that the administration inherited a "deeply flawed global trade system" and its efforts and actions are designed to improve a number of these issues. Besides successfully concluding renegotiation of NAFTA into the United States-Mexico-Canada Agreement (USMCA), the report focuses on the overreach of the World Trade Organization's (WTO) Appellate Body and several unfair trade practices from various US trading partners, emphasizing many of China's nonmarket policies and behaviors.

The administration states a primary goal of obtaining Congressional approval for USMCA, as part of its sustained steps to improve domestic trade policies. It also goes on to outline a number of trade issues with China and the administration's views that the WTO is in need of reform, including assertions that the WTO Appellate Body has issued overreaching decisions





that are averse to US interests. To achieve a number of these objectives, the administration extensively used several legal tools, such as Section 232 of the Trade Act of 1962 (Section 232) and Section 301 of the Trade Act of 1974 (Section 301) to impose significant tariffs on a wide range of global imports and to enforce a number of trade remedies laws.

This commitment to domestic industry, as well as international trade, can be seen in the administration's recent actions. These actions include:

- ▶ Denying much of exclusion requests for products on USD34 billion worth of Chinese imported products (List 1) under Section 301 while granting limited exclusions
- ▶ Denying to date approximately one-third of exclusion requests for products on USD16 billion worth of Chinese imported products (List 2) under Section 301
- ▶ Increasing tariffs from 10% to 25% on USD200 billion worth of Chinese imported products (List 3) under Section 301
- ▶ Initiating the process for creating a "List 4" of many remaining Chinese products not already covered prior actions (approximately USD300 billion of products proposed) under Section 301
- ▶ Placement of Huawei Technologies and 68 of its non-US affiliates on the Bureau of Industry and Security (BIS) entity eliminating steel and aluminum tariffs under Section 232 for imports from Mexico and Canada
- ▶ Reducing Section 232 duties on imported Turkish steel from 50% to 25% and removing Turkey from the Generalized System of Preferences (GSP)
- ▶ Delaying Section 232 duties on automobiles and automobile parts

An outline of the US trade measures and the corresponding or retaliatory responses from around the globe can be found in our [Global Trade disruptors magazine](#).

Amidst this flurry of trade policy, on 25 April 2019, the Office of the United States Trade Representative (USTR) published its annual Special 301 Report (the Report) identifying US trading partners which it considers do not provide adequate protection and enforcement of intellectual property rights (IPR), such as copyright, patents and trademarks.<sup>1</sup> In its Report, the USTR categorizes countries that do not provide adequate and effective IPR protection, or fail to provide an equitable market for US individuals and businesses that rely upon such rights, into three lists: Priority Foreign Countries, Priority Watch List and Watch List. While the 2019 Report did not identify any Priority Foreign Countries, 11 countries were included on the 2019 Priority Watch List,<sup>2</sup> and 25 countries were included in the 2019 Watch List.<sup>3</sup> See the [Overview of recent United States Trade Representative \(USTR\) Section 301 Report](#) article on page 9 in this edition for further reading.

1 USTR Special 301 Report (2019), available at [https://ustr.gov/sites/default/files/2019\\_Special\\_301\\_Report.pdf](https://ustr.gov/sites/default/files/2019_Special_301_Report.pdf).

2 2019 Priority Watch List Countries: Algeria, Argentina, Chile, China, India, Indonesia, Kuwait, Russia, Saudi Arabia, Ukraine, and Venezuela.

3 2019 Watch List Countries: Barbados, Bolivia, Brazil, Canada, Colombia, Costa Rica, Dominican Republic, Ecuador, Egypt, Greece, Guatemala, Jamaica, Lebanon, Mexico, Pakistan, Paraguay, Peru, Romania, Switzerland, Thailand, Turkey, Turkmenistan, the United Arab Emirates, Uzbekistan and Vietnam.

Following the failure to reach an agreement with China, President Trump ratcheted up action against China under Section 301. On 8 May 2019, the USTR announced that the US will move forward with increasing tariffs List 3 from 10% to 25%.<sup>4</sup> Following the initial Lists 1 and 2 focused primarily on industrial products, List 3 is by far the more expansive of the lists with covered products falling within 80 chapters of the Harmonized Tariff System of the United States. In a corresponding move, the USTR also issued the fourth round of exclusions to the Section 301 tariffs levied on USD34 billion<sup>2</sup> worth of imports from China annually (US List 1).<sup>5</sup> With this fourth action, the total amount of exclusions has risen to 18.06%, while denials have increased to 55.41%. Exclusions for List 2 have yet to be released, but the USTR did release the first set of denials, which included 956 requests or approximately 33% of total requests.

On 15 May 2019, President Trump signed an executive order declaring a national emergency in response to threats from foreign “adversaries” in the creation or exploitation of vulnerabilities in information and communication technology.<sup>6</sup> The order prohibits the acquisition, importation, transfer,

installation, dealing in or use of any information and communications technology or service by any person where the transaction poses a risk to the national security or foreign policy of the United States. The U.S. Department of Commerce subsequently announced the addition of the Chinese company Huawei Technologies to the Entities List for activities contrary to the security interests of the US. This will make export and re-export transactions with Huawei subject to a presumption of denial and require export licenses. President Trump has explicitly used invoking national security rationale in his trade actions. Section 232 allows the adjustment of imports in circumstances that threaten to impair the national security. The concept of national security embodied in Section 232 is considerably broad; such use of the statute to levy tariffs on steel and aluminum recently survived a constitutional challenge.<sup>7</sup>

Besides a broad imposition of Section 232 duties on a majority of world producers of steel and aluminum materials, at 25% and 10% respectively, President Trump also utilized Section 232 to impose tariffs on steel imports from Turkey at 50% based on specific determinations of trade actions and data

from Turkey. However, citing improved conditions in the US steel industry and reductions in Turkish exports, President Trump reduced the tariff rate from 50% to 25% in an executive order on 16 May 2019.<sup>8</sup> In a coordinated action with the reduction of tariffs, Turkey was also removed from the list of beneficiary countries for the GSP based on a finding that continued treatment as a developing country was unwarranted.<sup>9</sup> This latter action demonstrates the administration’s efforts to reduce trade-related benefits to countries where economic support is no longer determined appropriate.

On 17 May 2019, President Trump directed the USTR to pursue negotiation of agreements with respect to imported automobiles and certain automobile parts from the EU and Japan or any other country the USTR deems appropriate.<sup>10</sup> This action forestalled a pending decision to impose tariffs or quotas under Section 232 for up to 180 days to allow for an agreement to be reached with either or both countries. If the US does not come to an agreement with the EU or Japan, the president still has the option to adjust imports by using tariffs or quotas. President Trump hopes to use the delay in tariffs to help secure greater access to Japanese markets for American agricultural producers.<sup>11</sup>

Finally, in what appears to be a conciliatory move, the USTR announced on 19 May 2019, an agreement to remove the Section 232 tariffs on steel and aluminum imports from Canada and Mexico without a long-stated objective of imposing a tariff quota to monitor imports from both countries in exchange for lifting of retaliatory duties on US products exported into both countries. This

2 2019 Priority Watch List Countries: Algeria, Argentina, Chile, China, India, Indonesia, Kuwait, Russia, Saudi Arabia, Ukraine, and Venezuela.

4 <https://www.govinfo.gov/content/pkg/FR-2019-05-09/pdf/2019-09681.pdf>.

5 [https://ustr.gov/sites/default/files/enforcement/301Investigations/Notice\\_of\\_Product\\_Exclusions\\_05.09.19.pdf](https://ustr.gov/sites/default/files/enforcement/301Investigations/Notice_of_Product_Exclusions_05.09.19.pdf).

6 <https://www.whitehouse.gov/presidential-actions/executive-order-securing-information-communications-technology-services-supply-chain/>.

7 <https://www.cit.uscourts.gov/sites/cit/files/19-37.pdf>.

8 <https://www.whitehouse.gov/presidential-actions/proclamation-adjusting-imports-steel-united-states/>.

9 <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/march/united-states-will-terminate-gsp>.

10 <https://www.whitehouse.gov/presidential-actions/adjusting-imports-automobiles-automobile-parts-united-states/>.

11 [https://www.washingtonpost.com/business/whats-at-stake-in-us-japan-trade-talks/2019/05/26/b2fc7c10-8026-11e9-b585-e36b16a531aa\\_story.html?utm\\_term=.b1ba547de823](https://www.washingtonpost.com/business/whats-at-stake-in-us-japan-trade-talks/2019/05/26/b2fc7c10-8026-11e9-b585-e36b16a531aa_story.html?utm_term=.b1ba547de823).

agreement was accompanied by a proclamation that such imports no longer posed a threat to national security. President Trump had imposed 25% tariffs on steel products and 10% tariffs on aluminum products under Section 232. The agreement includes a complicated monitoring process commitment for non-Mexico or Canadian steel products imported into each country and ultimately destined for the US. As such, the removal of tariffs creates a de facto quota for steel imports at current rates of import.<sup>12</sup> More importantly, however, the agreement is anticipated to permit the next steps necessary to obtain passage of the USMCA later this year.

President Trump's use of Section 232 in trade policy has not gone without challenge. On 5 April 2019, a WTO Dispute Settlement Panel (the Panel) concluded Russia properly invoked a national security exception under the 1994 Global Agreement on Tariffs and Trade (GATT) during 2016.<sup>13</sup> Russia invoked the GATT Article XXI(b)(iii) exception in response to Ukraine's claim that certain Russian travel bans and restrictions denying traffic in transit by road or rail across Russia to other countries were contrary to its WTO commitments.<sup>14</sup> This decision may significantly impact disputes currently pending with the WTO Dispute Settlement Body, including complaints challenging US tariffs implemented on certain steel and aluminum imports pursuant to Section 232. See article *WTO rules in favor of Russia in Russia-Ukraine transit dispute: potential impact on section*

*232 disputes* on page 23 in this edition for a more detailed discussion on this topic.

Over the last two months, the Trump administration has made several targeted moves to advance the five pillars of his trade policy agenda. Most recently, these moves have largely been taken under the auspices of national security, whether de jure under Section 232, or de facto, in response to public declarations of specific national security threats.

### Actions for businesses

Given the breadth of Trump's trade actions, companies operating in virtually all industries should continue to monitor developments and consider actions that provide alternatives for mitigating the overall impact of increased duties as well as impacts of trade policy.

Duty mitigation strategies to consider include:

- ▶ Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs, 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, Chapter 98 and equivalent programs under China customs regulations

- ▶ Exploring strategies to minimize the customs value of imported products subject to the additional duties, re-evaluating current transfer pricing approaches, and for US imports, considering US customs strategies, such as First Sale for Export ■



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<sup>12</sup> <https://business.financialpost.com/news/economy/update-1-u-s-nears-removal-of-tariffs-on-canada-mexico-metals-media>

<sup>13</sup> See Article XXI(b)(iii) of the 1994 Global Agreement on Tariffs and Trade (GATT).

<sup>14</sup> These measures included the 2016 Belarus Transit Requirements and the 2016 Transit Bans on Non-Zero Duty and Resolution No. 778 Goods, which restrict transit by road and rail from Ukraine destined for Kazakhstan or the Kyrgyz Republic from transiting directly across the Ukraine-Russia border, requiring traffic to detour through Belarus, and meet additional requirements at specific control points, and prohibit such transit for certain classes of goods subject to authorized exceptions.

# The new era of FTA self-help and of enhanced FTA utilization in Asia



In the last five years, the number of Free Trade Agreements (FTAs) in negotiation or completed in Asia increased 14%, or by 42 FTAs.<sup>1</sup> With expansion of the FTA landscape, it was a matter of time before governments turned their attention to the real test – the usefulness of these FTAs for companies.

FTAs can help assist the increase of exports, bringing subsequent benefits of job creation and wage raises. This is of considerable value to developing countries in Asia.<sup>2</sup> These benefits will not manifest just because an FTA has been negotiated, but only when local companies are able to utilize the FTA to enhance their businesses.

Hence there is an increasing trend of governments paying attention to FTA utilization rates and working to enhance this area. This is especially for developing countries whose preference utilization rates (PUR) tend to be low, with Asia being at 28%, while PURs for US and EU are high. Take for example Thailand which saw US\$69.6 billion FTA privilege use in 2018, a 15.2% increase from 2017<sup>3</sup>, and Korea whose efforts to enhance FTA utilization were able to bring utilization rates from around 20% in 2010 to an average of around 70% as of November 2013.<sup>4</sup>

## **Governments are making professional FTA support available**

One of the key measures that the Korean government employed which led to the FTA utilization improvement was to provide FTA consulting to companies. This was based on a study done in 2013 that found that “consulting was considered to be the most efficient means of enhancing FTA utilization”. This was done in two main ways – providing traditional consulting services which were subsidized; coupled with “smart” FTA self-help services using a FTA portal.

The first way included financial support to cover FTA business consulting costs as well as establishing a FTA call centre which arranged for professional FTA consultants to take more than 5000 calls in the first five months of opening. Immediate consulting was provided based on the questions raised by callers and follow-up on-site consulting provided for the companies in question. Korea also provided FTA training in universities and courses for FTA consultants and experts.

1 Free Trade Agreements, Asia Regional Integration Center-Tracking Asian Integration website, <https://aric.adb.org/fta>, accessed 2nd May 2019.

2 Increased Exports in India Can Improve Jobs, Raise Wages, The World Bank website, <http://www.worldbank.org/en/news/press-release/2019/02/28/increased-exports-in-india-can-improve-jobs-raise-wages>, 28 February 2019.

3 FTA and GSP use beats 2018 target, Bangkok Post website, <https://www.bangkokpost.com/business/news/1631262/fta-and-gsp-use-beats-2018-target>, 18 February 2019.

4 Korea's Policy Package for Enhancing its FTA Utilisation and Implications for Korea's Policy, ERIA discussion paper series, <http://www.eria.org/ERIA-DP-2014-11.pdf>, May 2014.

The second way involved providing systematic analysis solutions for searching of tariffs and product-specific rules of origin in an FTA portal for companies to use.<sup>5</sup>

Automation of FTA benefit identification is a big change. When FTAs were first implemented, a potential user of FTAs had to go online or write to a government officer. Ultimately, they would often have to review long legal documents written in convoluted jargon and try to apply this to their business. The installation of the tariff finder, a simple search function that identifies a product's FTA benefits and sometimes rules of origin by harmonised system code, not only in Korea but across a range of countries with different FTAs, was of considerable benefit.

### **Beyond FTAs – making international trade more transparent and more certain for business**

In the last five years, not only have more countries put up tariff finders, tariff finders have also evolved, moving beyond just searching for the tariff benefit of a product and the occasional specific rule of origin.

Singapore's tariff finder includes the VAT rate of the importing country and import formalities, including details on processing fees and the contact details of relevant authorities in the importing market.

The Australian tariff finder is at the same time a service finder which provides information on all Australian FTA service commitments and provides import market data relating to the product in question.

Tariff finders are now also commissioned for specific FTAs. For example, the ASEAN-China Free Trade Area has a dedicated ASEAN China business portal with a tariff finder which allows search of tariffs for trade of goods between the members of this FTA and also services commitments which are agreed to under this FTA. The portal contains samples of the certificate of origin and also the application process in all the FTA member countries, down to specific procedures for each of the thirty-four provinces of China.

### **Implications**

As tariff finders grow more powerful and omnipotent, what does this mean for companies?

First of all, tariff finders now allow companies to more readily identify the potential FTA benefits for their products and understand what this means for their business. However, knowledge of FTA benefits and the specific rules of origin are but the first step of realizing the potential FTA benefits being offered. The more difficult second step is to understand the manufacturing processes and supply chain logistics to understand what needs to be done to comply with the rules that govern FTAs. In a time of increasing compliance scrutiny by regulators, it is critical to ensure that the rules of origin are sufficiently met and that shipping documents and process do not invalidate the FTA benefits. Companies need to establish robust controls to ensure that FTA benefits are retained should they come under review and audit.

As such, we believe that tariff finders are a positive development for both businesses and trade consultancy services. The expansion of FTA awareness will allow companies greater potential to grow their international business to the fullest potential, whilst trade consultants will also benefit from these companies investing in understanding and establishing what's necessary to access and retain the FTA benefits that are available. ■

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<sup>5</sup> Korea's Policy Package for Enhancing its FTA Utilisation and Implications for Korea's Policy, ERIA discussion paper series, <http://www.eria.org/ERIA-DP-2014-11.pdf>, May 2014.



# Enhanced benefits of Australia's next generation AEO program

## **The challenge of today's global supply chains**

Over the last few decades, companies have "globalised" at an incredible pace. Today we see hugely complex supply chains that traverse many countries. Raw materials, intermediate and finished products cross many borders on their journey to a consumer. Recent trade tensions will not reduce these complex network of cross border movements. Instead, companies are responding by changing supply chains, often simply sourcing products from a different country in an effort to reduce their ultimate risk of trade sanctions.

We are also in a time of enhanced regulatory complexity as companies are embracing the opportunities, and challenges, afforded by an ever-growing number of Free Trade Agreements (FTA's).

Governments have similarly been challenged with globalisation. They are attempting to support the increase in movement of goods cross border, whilst also addressing security in the supply chain, revenue collection and protection, etc.

Against this backdrop for both companies and governments, there is a need for trade to have integrated, harmonised and international standards to support cross border supply chains.

## **A programme to facilitate cross-border movement of goods**

An example of international standards is the Authorized Economic Operator (AEO) concepts, which are developed and regulated via the SAFE Framework of Standards from the World Customs Organization. The international standard also regulates how national AEO programmes can be inter linked for the supply chain through a Mutual Recognition Agreement (MRA) mechanism.

Currently, there are more than seventy countries with operational AEO programmes. Many other countries are in the process of developing their AEO programs, thus making AEO type programs one of the most important standards for international trade. In addition, the World Trade Organization (WTO) has made AEO type programmes one of the key pillars of the Trade Facilitation Agreement.

For many countries, the uptake on AEO participation has been weak. Enthusiastic early adopters have not always been followed by significant numbers of companies wanting to be in the AEO programme. Quite simply, many of the older AEO programmes lacked key features necessary to increase participation in the programs and progress Trade Facilitation to increased levels.



### **Promoting the AEO programme with enhanced benefits**

However, in the last few years we are seeing updated AEO programmes come into force which are broader, holistic and provide more benefits, not only in respect of cross border trade. The idea behind some of these programmes is that all stakeholders of the international supply chain should collectively cooperate to minimise risks in their global supply activities. It is encouraging closer connectivity of people with goods and border management. Countries have also collaborated in designing and implemented modern “Trusted Trader Programmes” as part of the AEO framework.

An example is the Australian Trusted Trader programme (ATT) which was launched in July 2016. The Department of Home Affairs (DoHa) has taken an innovative approach to trade facilitation. The program is encouraging any organisation that is active in international supply chain activities to become accredited. Subsequently, there has been a stronger up-take from freight companies, importers, exporters of all shapes and sizes participating in the program.

In terms of developing the benefits for accredited companies, DoHa is taking a collaborative approach in its pursuit of increasing the levels of participate in the program. One benefit implemented is a “seat at the table”, which enables organisations to congregate on a yearly basis and voice key issues impacting trade facilitation.

### **Supporting the use of Free Trade Agreements – a key feature**

Subsequently, numerous benefits have been introduced which are delivering tangible results for many organisations. An example is the “ATT Origin Advance ruling” which assists accredited companies importing goods under the China Australia Free Trade Agreement (ChAFTA). The benefit allows importers to request a single, special advance ruling that refers to goods classified under multiple tariff classifications and consignments. The ruling replaces the need for the conventional advance rulings or transactional Certificate of Origins, thus reducing the administrative burden with obtaining Certificates of Origins and the associated direct costs. It is anticipated this benefit will be extended to other FTA's Australia has established. In a world of complex FTA's where many companies have declined to avail of FTA benefits due to risks associated with compliance and burdensome administration, this is a significant benefit that can materially impact an importer.

### **An AEO network and benefits beyond the supply chain**

Other examples of looking beyond the traditional approach associated with AEO programs is the inclusion of benefits to companies relating to the International movement of people. Streamlined processing of temporary skill shortage visas has been made available to accredited companies in Australia, which has seen applications processed in less than 5 days. APEC travel cards which offers faster and easier entry to APEC countries for business travellers is another.

Furthermore, the ATT program is becoming an enabler for fast and secure border management model for goods with minimum infrastructure, through the development of MRA's between many of Australia's key trading partners China (mainland), Hong Kong, Korea, Taiwan, Singapore, New Zealand and Canada are in place, and more are being pursued with other trading partners. This has seen many exporters join the program to benefit from enhanced processing of customs formalities at overseas borders. The arrangements provide priority treatment, which enables faster processing and means more predictability and quicker access to overseas markets – another significant benefit.

There is no doubt a modern AEO programme can be one element to future trade efficiency. We are seeing a new AEO paradigm approaching and is why all companies involved in international trade should reconsider applying for accreditation wherever you can. It is the best guarantee for access to future trusted trade lanes but also to enhance trade facilitation. ■

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# Philippine customs audit: common issues



Businesses that import goods into the Philippines may encounter a number of common audit issues.

When shipments are “cleared” at the border after payment of duties and taxes, importers often assume that the Bureau of Customs (BoC) will simply move on without double-checking the shipment. This assumption is inaccurate. The BoC can actually conduct an audit of past transactions, similar to the function of the Bureau of Internal Revenue (BIR). This exercise is the Post-Clearance Audit (PCA). It usually covers the last three years of importations and the PCA is undertaken to check the correctness of importers’ goods declarations, and the accuracy of their tax payments.

The BoC recently issued Customs Administrative Order (CAO) No. 1-2019, which sets new rules in the conduct of PCAs effective 15 February 2019. In this article we focus on the following:

- ▶ What exactly will the BoC look for?
- ▶ What are the common issues that importers should anticipate?
- ▶ How should importers deal with the common issues in a PCA?

### Record keeping

After an Audit Notification Letter is issued, the first order of business is for the importer to submit various importation documents identified in a checklist. The most common documents required are those that pertain to shipping, importation, and transport. These are the Single Administrative Documents (SAD) or the actual goods declarations, commercial invoices from foreign suppliers, supply agreements, import licenses and permits (for regulated imports), bills of lading or airway bills, packing lists, freight and insurance documentation, and Certificates of Origin (if lower duty rates under Free Trade Agreements or FTA were used). The BoC can also require other documents such as Audited Financial Statements, filed tax returns, and schedules of importations for the period covered by the audit. The auditors also have the authority to visit the company for verification purposes.

In this documentation exercise, the BoC will assess if the importer complies with the obligation to keep importation records. Lack of or incomplete documentation could lead to penalties, including a surcharge of 20% of the value of the goods for which no records are kept or maintained. To overcome this issue, importers should gather importation documents and ensure that they are complete before the PCA begins.

The significance of proper record keeping bears repeating, because the BoC will identify the core common issues in an import transaction on the basis of the documents you present to them.

### Valuation

When an importer declares the value of imported goods at the border, it does so based on its own assessment. Hence, it becomes necessary during a PCA for the BoC to evaluate if the importer's assessment is correct and compliant with existing valuation methods.

Valuation involves a wide range of sub-issues. Here are some of the most common ones:

- ▶ *Proper declaration of value, in general* – For transactions between a related foreign supplier and importer, the BOC will inquire if the price of the goods is arms-length; meaning, it was not influenced by the relationship between the parties. Similarly, for transactions between unrelated parties, the BoC can question the value declared by the importer based on existing reference values available in the BoC database, or elsewhere.
- ▶ *Accurate declaration of the cost-insurance-freight (CIF)* – The BOC counterchecks if the CIF per invoice, insurance, and freight documentations tally with the CIF declared in the SADs, applying the specific rules on the proper declaration of such items.
- ▶ *Existence of additional payments to suppliers* – Additional payments made after importation can form part of the dutiable value of the imported goods. These include items such as transfer price adjustments, dutiable royalty payments or license fees, and proceeds of subsequent resale of imported goods.

- ▶ *Proper declaration of all other components of the dutiable value of imported goods* – The BoC can likewise check if the importer properly included all adjustments to the price of imported goods, such as dutiable commissions, packing costs and charges, assists, interests, and transport costs, among others.

### Classification of goods

In all importations, the importer should be able to properly 'classify' goods under the applicable 8-digit tariff code, or Harmonized System (HS) code. Each unique code has a corresponding duty rate that applies to goods classified under such code. In a PCA, the BOC will check if the importer captured the correct classification and used the applicable rate when it paid the duties.

In case of doubt in the applicable classification, the BoC may ask the importer to establish proof of proper classification, such as details of the imported goods and tariff classification rulings obtained in the past. For importers who make use of lower duty rates available under existing FTAs, the BoC can perform a more detailed assessment. This involves a validation of compliance with the origin rules under the FTAs, as well as the availability of the supporting document called the Certificate of Origin (CO). If they fail to refute questions on origin or present COs, the importers may end up losing the privilege of using the lower duty rates.

### Where the importer enjoys duty and tax incentives

There is a common misconception that importers who enjoy exemption from paying duties and taxes (such as economic or freeport zone locators, or even importers through a bonded warehouse) are relieved from customs audits. In fact, the BoC remains strict in its audits of special importers, to verify if there are any duty and tax leakages in their activities.

Some of the common issues specific to importers with incentives are:

- ▶ *Actual entitlement to incentives* – The BoC checks if importers have proof of entitlement to the incentives such as their Certificates of Registration and Registration Agreements. Normally, there is a determination if the importations are within the limits of the registered activity.
- ▶ *Domestic sales* – Goods imported into an ecozone, freeport zone, or bonded warehouse are normally destined for export. In the case of domestic sales, the BoC would like to see if duties and taxes were paid on such sales.
- ▶ *Proper liquidation of raw materials* – The BoC asks importers to completely account for the raw materials imported free from duties and taxes. Failure to do so can trigger a deficiency assessment.

- ▶ Availability of records – In relation to the record keeping requirements, the BoC checks if there is proper entry documentation, particularly import permits for ecozone locators.

### Other relevant issues

The BoC also typically raises other issues, such as the proper computation of duties (components of dutiable value and forex conversion) and VAT (components of landed cost), payment of excise tax for certain articles, among others.

Upon looking at values declared per SAD, VAT returns, and other relevant schedules, the BoC also identifies discrepancies for possible reconciliation. The importer is then required to reconcile discrepancies which could be a lengthy exercise. For failure to fully reconcile, issues may be raised such as incompleteness of records, underpayment of taxes, and in extreme circumstances, allegation of smuggling.

Needless to say, there are many other issues that the BoC may raise, depending on the circumstances of each audit. Now that PCAs are well on their way, the most prudent action for importers is to perform a self-assessment for an early detection of potential issues. When importers are “audit ready,” they will be able to better remedy or mitigate any consequences before a PCA commences. ■

**If you have any questions or specific concerns relating to those discussed above, or with any indirect tax issue for that matter, you may kindly reach out to EY Philippines' Indirect Tax Partners/ Principals below:**

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# WTO Boeing dispute: EU issues preliminary list of US products considered for countermeasures



On 17 April 2019 the European Union (EU) published a preliminary list of US products considered for countermeasures in the WTO Boeing dispute that has been pending since 2012. In 2012 the WTO ruled that the U.S. had granted considerable subsidies to Boeing running contrary to WTO rules. It was established that between 1989 and 2006 Boeing benefited from several subsidies totaling over USD5 billion.

On 11 April 2019, the Dispute Settlement Body of the World Trade Organization adopted reports in which the Appellate Body, the highest WTO judiciary, confirmed that the U.S. has not taken appropriate action to comply with the WTO rules on subsidies ([www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds353\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm)). In the ruling of 28 March 2019, the Appellate Body confirmed that:

▶ The Washington State tax program continues to be a central part of the US unlawful state aid to Boeing. This program is scheduled to run up until 2040 with a continuous increase of subsidies expected throughout that period. Boeing will receive an estimated total of USD6 billion in tax savings for the period 2006-2040.

- ▶ That a number of ongoing instruments, including certain NASA and U.S. Department of Defense procurement contracts, research and development programs, and South Carolina job tax credits, constitute subsidies that may cause economic harm to Airbus.
- ▶ Boeing still benefits from an U.S. tax concession that supports exports (the Foreign Sales Corporation and Extraterritorial Income Exclusion, or FSC/ETI). This subsidy has already been qualified as prohibited, which means illegal under WTO rules.

The list published on 17 April 2019 covers a range of items, from aircrafts to chemicals and agri-food products but also certain bicycle and motorcycle parts that overall represent around USD20 billion of United States exports into the EU ([http://trade.ec.europa.eu/doclib/docs/2019/april/tradoc\\_157861.pdf](http://trade.ec.europa.eu/doclib/docs/2019/april/tradoc_157861.pdf)). Earlier in this dispute, in 2012, the EU already made a request to the WTO to authorize the adoption of countermeasures worth up to USD12 billion, equivalent to the estimated damage caused to Airbus by the U.S. support to Boeing.

Following the 11 April 2019 decision of the WTO Appellate Body, the EU's request will now be dealt with by a WTO appointed arbitrator, which will determine the appropriate level of countermeasures that EU can impose. The EU has requested the arbitrator to resume its work. Based on the decision of the arbitrator and the results of a consultation in the EU, a final list will be published. This final list will be based on the preliminary list published on 17 April 2019.

The list published on 17 April 2019 is a preliminary list. Therefore it is not certain whether all products mentioned in the list will be subject to the countermeasures. It is also not known yet what the duty rates will be on the products eventually selected for the final list. However, businesses which are involved in export from the US and import into the EU of products on the preliminary list should follow the developments in the coming months as the definitive measures will be shaped. ■

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## Customs valuation and transfer pricing: Hamamatsu – the journey continues

On 20 December 2017, the European Court of Justice (ECJ) decided the widely noted Hamamatsu case and the outcome raised more doubts for importing companies regarding the application of the transfer price than that it provided the anticipated clarity. After the subsequent decision of the local Fiscal Court in Munich, which had referred the case to the ECJ, the revision has now been filed to the Federal Fiscal Court (Bundesfinanzhof), which is the highest tax court in Germany. In the following, we will outline the case, its status and relevant observations.

### Background of the case

Hamamatsu Germany (H/DE) is a subsidiary of Hamamatsu Japan (H/JP) and locally distributes goods, which H/DE directly receives from H/JP

in Japan. H/JP and H/DE concluded in 2009 an Advanced Pricing Agreement (APA) for the period October 2006 to September 2010.

Transfer prices were preliminary set according to an APA and were adjusted at the end of the transfer pricing period. At the end of the year, H/DE's profit level was below the target range for the relevant period. Hence, H/DE received a lump-sum credit note from H/JP.

During the period under dispute, approximately 1,000 shipments were released for free circulation in the EU. H/DE lodged a refund application to the customs authorities, in which refund was claimed based on the average duty rate of all shipments taken together, i.e., no assignment of the corrections to the respective single transactions was performed.

The local customs authority in Munich rejected the global correction of the total price, since the adjustment amount was not broken down by product and import transactions. Furthermore, they argued, that the mechanism for pricing and adjustments was not agreed upon in detail in advance. The customs authority stated that subsequent refunds would only be possible if, prior to import, the final total price was precisely defined by a formula and would evidently relate to the imports.

H/DE argued that it was a so-called average duty rate analysis which, for the purposes of the external comparison, assumed that all goods imported would achieve the same return on sales. Article 29 of the Community Customs Code also points to the actual price paid.

### Essence of the ECJ decision

The ECJ was requested for a judgment on whether a transaction value can be adjusted by retrospective correction of the actual price payable.

The decision of the ECJ was made under the Community Customs Code (in force until May 2016), but is still valid for the new Unions Customs Code as general questions concerning customs valuation and transfer price adjustments are discussed. The ECJ refers to its case law to iterate that the customs value should primarily be based on the transaction value of the imported goods and only if such value cannot be determined at the time of import, alternative methods of valuation should be used.

The ECJ stated that in case of an initially reported customs value retroactive adjustments, be it downwards or upwards, cannot be applied. A transaction value for customs valuation purposes





cannot consist of a preliminary value and a down- or upward adjustment afterwards. Consequently, a tax-driven APA does not imply the acceptance of prices and corresponding adjustments for customs valuation purposes.

### **Decision of the Fiscal Court in Munich**

The Fiscal Court in Munich essentially denied the possibility for retroactive correction of import declarations in the context of transfer pricing in this case. Remarkable in this context was the explicit criticism of the Fiscal Court in Munich of the judgment of the ECJ. In the opinion of the Fiscal Court in Munich, the judgment of the ECJ is only reproducing settled case-law with purely factual statements, leaving fundamental questions unanswered. According to the Fiscal Court in Munich, the result contradicts settled case-law concerning customs value and taxation in general – i.e., the actual economic value of an imported goods should be reflected in the customs value.

Against this background, the Fiscal Court in Munich granted the possibility for revision at the Federal Fiscal Court (“BFH”) to allow the case to continue. As the rate of allowed revisions in Germany is below 5%, this underlines that the judgment of the ECJ is regarded as unsatisfactory and not providing solutions for the treatment of transfer pricing adjustments for customs valuation purposes.

### **Current state**

#### **View of the customs authorities**

The German customs authorities have a particular interpretation of the Hamamatsu judgment of the ECJ. In essence, the German customs authorities are of the opinion that their view is not to be changed. As a consequence, they demand price increases to be retroactively included in the customs value, arguing that the price has been influenced by the relationship of the parties. For refunds in case of retroactive credit notes, the German customs authorities take the position that the possibilities of a refund are very limited. This means that their previous view (pre-Hamamatsu), that a refund is only granted if there is an exact defined calculation scheme allowing an auditor to precisely determine the credit payment and allocate the payment to the respective import goods, is in question as they argue that the ECJ decision does not allow for retroactive correction of the transaction value at all.

**Next steps in the court procedure**

Start Procedure	2015	Filing at Finance Court Munich 14K 1974/15
	2016	Order for a preliminary ruling of the ECJ by the Finance Court Munich 15.09.2016 – 14K 1974/15
	2017	Preliminary decision ECJ 20.12.2017 – C – 529/16
	2018	Decision Finance Court Munich 15.11.2018 – 14K 2028/18
	2019	Revision currently pending at BFH
Conclusion	2020+	Decision of BFH

The Hamamatsu case has been escalated to the Federal Fiscal Court. At the time of drafting this article, the German customs authorities are preparing their legal argumentation against the legal action filed by the legal representative of Hamamatsu. It is expected by the customs authorities that a renewed legal question is filed by the Federal Fiscal Court to the ECJ. A decision of the Federal Fiscal Court is expected in 2020.

**What does this mean in practice?**

From a German authorities' perspective there are, because of the Hamamatsu judgment of the ECJ and the judgment of the Fiscal Court in Munich, no direct implications for the previous interpretation and application of the law.

**Credit notes**

The chances that the German customs authorities accept a lump-sum downward TP adjustment to reduce the customs value of goods within the transaction value method, has decreased to almost zero. Refunds of overpaid customs duties are currently regularly rejected by the customs authorities.

**Debit notes**

As German customs authorities assume that the price payable was influenced by the relationship in case of upward adjustments, additional customs duty payments are still assessed. In various countries (amongst others, Germany), there are provisions in the local tax regulations that demand taxpayers (here importers) to give notice to the involved authorities if relevant parameters for the tax debt (such as price as basis for the import value) change.

**Call for action**

In any case, it is advisable to declare retroactive adjustments, i.e., to apply for a refund in case of credit notes and to inform Customs in case of debit notes to clearly demonstrate that prices have been adjusted. This ensures on one hand compliance, but also safeguards any refund potentials that may arise, if the Federal Fiscal Court will arrive after a likely consultation with the ECJ at another conclusion.

As a consequence, additional payments resulting from debit notes should be appealed and procedurally set dormant under the light of the still pending case.

In case of rejected refunds, it is recommendable to appeal and set the process dormant, as a new guidance might enable for a customs consideration of the credit note.

**Other EU Member States**

Given the unclarity of the Hamamatsu judgment, the positions taken in other Member States can differ from Member State to Member State. It is therefore recommendable to closely follow the developments in Germany and to safeguard positions regarding refund requests refused by customs authorities, i.e., file appeals against refusals to grant these. Upward price adjustments should still be reported to the customs authorities to avoid penalties for underpayment. However, it is advised to appeal against retroactive assessments issued in relation to upward price adjustments. ■

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# Recent developments and changes to the European Union Customs Code



## General state of play

Since the entry into force of the Union Customs Code (UCC) (EU Regulation 952/2013) – on 1 May 2016, the regulatory landscape for customs matters within the territory of the European Customs Union has been reshaped. Together with the UCC Delegated Act (Commission Delegated Regulation 2015/2446), the UCC Implementing Act (Commission Implementing Regulation 2015/2447) and the UCC Transitional Delegated Act (Commission Delegated Regulation 2016/28), the UCC has been the regulatory arm for modernized customs practices across the territory.

However, as is for every piece of legislation, provisions are sooner or later subject to corrections, changes and amendments. This is not different for some provisions of the UCC, as the Commission initiated a legislative procedure for amending several articles in June 2018. These proposals have recently found their way through legislation and are now laid down in EU Regulation 2019/474 of 19 March 2019.

Additionally, the European Commission already published a report on the state of implementation of the UCC, back in January 2018. The overall conclusion was that there were no real legislative problems; yet, project groups have been set up, thereby involving both Member States and trade representatives who will focus on subjects such as simplifications, low-value imports, transit and

guarantees. Besides, as stated by the Commission in the report, it would be necessary to extend the deadlines for several UCC electronic systems, to ensure a smooth implementation. On 17 April 2019, the European Parliament and the Council of the European Union eventually voted in favor of the prolongment of the transitional use of means other than the electronic data-processing techniques. EU Regulation 2019/632 changes article 278 of the UCC, extending the deadlines for implementation from 31 December 2020 ... until the end of 2025 ultimately.

In this article, we highlight the recent changes to the UCC as laid down in the Regulation 2019/474, and we focus on two main amendments to the UCC Delegated Act, i.e., the new definition of exporter and the reduction or waiver of guarantees.

## Changes to the UCC

All articles and amendments mentioned in EU Regulation 2019/474 have entered into force on 15 May, except for the arrangements regarding the expansion of the Customs Territory of the Union. Campione d'Italia – an Italian exclave in the territory of Switzerland – and the Italian waters of Lake Lugano will be included in the Customs Territory, but only as from 1 January 2020.

The most important changes to the UCC are the following:

1. The UCC has been amended to clarify that a holder of a binding tariff information (BTI) decision or a binding origin information (BOI) decision can use those decisions for up to six months after the BTI or the BOI have been revoked. However, this prolongment is only applicable if the revocation results from the fact that the decision does not comply with customs legislation or that the conditions laid down for taking BTI or BOI decisions have not been, or are no longer, fulfilled.
2. Temporary storage is now to be treated in the same way as customs procedures with regard to the extinguishment of a customs debt due to noncompliance. This is only true in cases where the failure had no significant effect on the correct operation of the procedure concerned, did not constitute an attempt at deception, and the situation was subsequently regularized.
3. The amended UCC makes it possible to use the customs declaration or the temporary declaration to submit the data and the information normally included in the entry summary declaration (ENS) in cases where no ENS could be filed on time. Note, however, that the local customs authorities where the goods are being presented need to allow for that possibility.

4. Lastly, a new article 260a has also been inserted. This provision states that if certain conditions are met, a total relief from import duties shall be granted for goods that have been repaired or altered under the outward processing procedure in a country with whom the EU has concluded an

international agreement providing for such relief. However, this will not apply to processed products resulting from equivalent goods (i.e., non-Union goods that are processed instead of Union goods) and to replacement products (as referred to in articles 261 and 262).





**The new definition of exporter**

The most thorough modification to the UCC-Delegated Act would be with respect to the new definition of exporter, which is mentioned in article 1(19) of this regulation. This amended definition already dates to August 2018, therefore we refer to previous TradeWatch editions<sup>1</sup> and EY Tax<sup>2</sup> alerts for more background. We will here restate the amendment and analyze the state of play across various Member States of the Union.

As the below comparison shows, the new definition is less restrictive, limits the conditions for being an exporter and gives companies greater flexibility to designate the person acting as the exporter:

We already explained in the EY alert that non-EU established entities could still act as exporter for customs purposes, as an exception, during the transitional period that was supposed to end by December 2020, on the condition that they appointed an indirect customs representative. December 2020 was indeed the deadline by which the Automatic Export System (AES) had to be implemented.

However, in April 2019, the EU prolonged the transitional use of means other than the electronic data-processing techniques provided for in the UCC to 31 December 2025 (Regulation 2019/632), due to “budget and operational” constraints from some Member States, making it impossible for the EU to have harmonized IT systems across the 27 Member States.

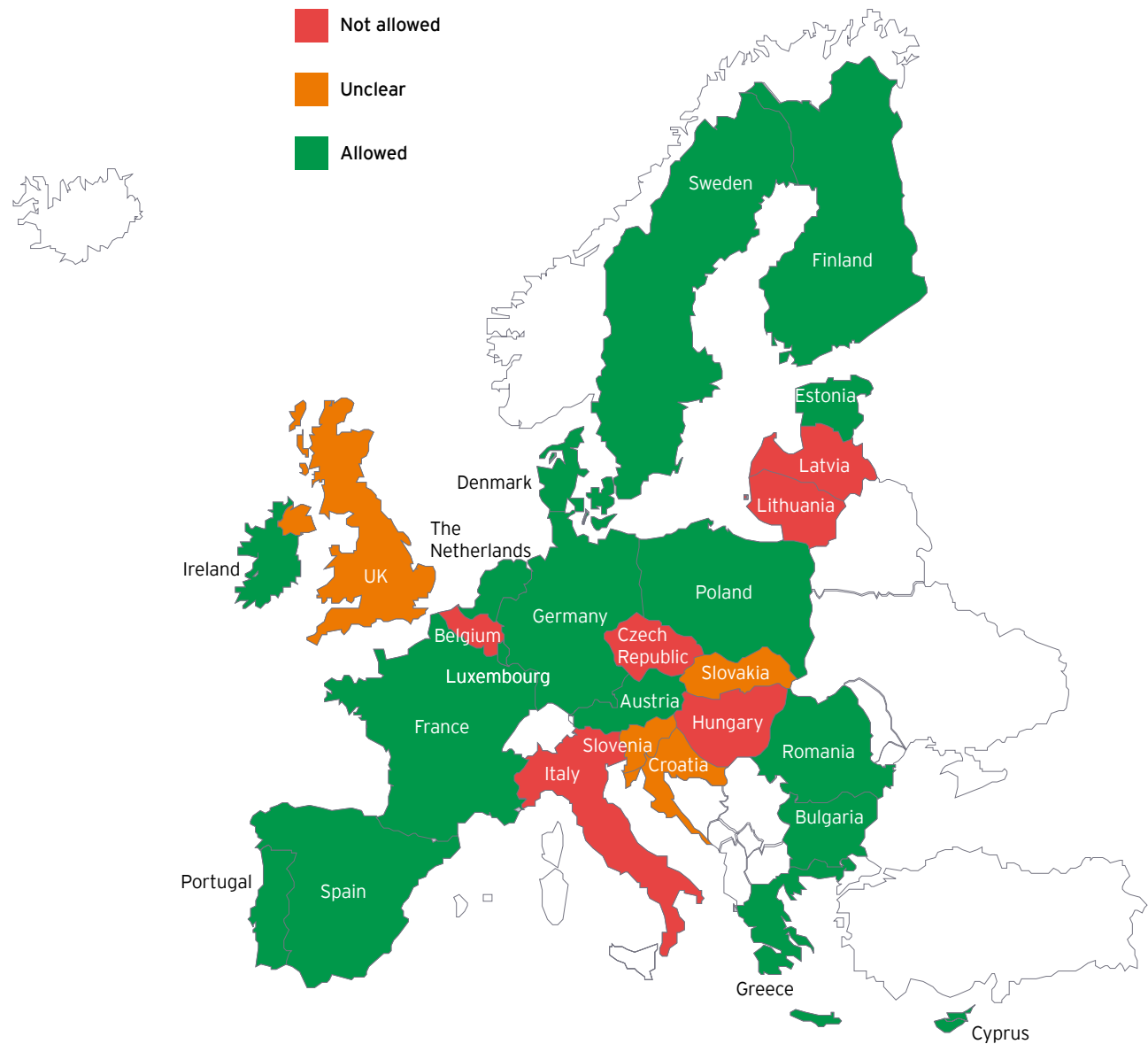
Old exporter definition	New exporter definition
Being established in the customs territory of the Union	
Holding a contract with a consignee in a third country	Has the power to determine and has determined that the goods are to be brought outside the customs territory of the Union
And	Or
Having the power to determine that the goods are to be brought outside the customs territory of the Union	Any party to the contract under which goods are to be taken out of that customs territory

1 Exporting from the EU after Brexit: changing definitions and consequences for FTA eligibility, p. 57, [https://www.ey.com/Publication/vwLUAssets/EY-trade-watch-march-2019/\\$FILE/EY-trade-watch-march-2019.pdf](https://www.ey.com/Publication/vwLUAssets/EY-trade-watch-march-2019/$FILE/EY-trade-watch-march-2019.pdf)  
 2 European Commission amends definition of exporter in the EU [https://www.ey.com/Publication/vwLUAssets/European-Commission-amends-definition-of-exporter-in-the-EU/\\$FILE/2018G\\_010770-18Gbl\\_Indirect\\_EC%20amends%20definition%20of%20exporter%20in%20the%20EU.pdf](https://www.ey.com/Publication/vwLUAssets/European-Commission-amends-definition-of-exporter-in-the-EU/$FILE/2018G_010770-18Gbl_Indirect_EC%20amends%20definition%20of%20exporter%20in%20the%20EU.pdf)

Technically, as a result of this extension, non-EU established companies would still be able to act as Exporter for customs purposes on the export customs declaration. Unfortunately, they may face different treatment on the ground though, as some Member States still follow the European Commission's revised guidance on the definition of the exporter (the tolerant approach), while others adopt a stricter stance and don't accept to see a non-EU established company acting as exporter in box 2 of the single administrative document (SAD).

This map gives a state of play based on an internal survey EY initiated for that purpose.

Due to this lack of harmonization between the different Member States, it is critical for businesses that are not established in the EU to better understand the impact of this on their operations and potentially rethink their outbound customs activities on the EU territory.



### The reduction or waiver of guarantees

A final amendment worth mentioning concerns the reduction or waiver of customs guarantees. This originates from Commission Delegated Regulation 2018/1118 of 7 June 2018, thereby also amending the UCC DA. As the existing rules turned out to be unworkable in practice, it was necessary to adapt the conditions required to benefit from a reduction or a waiver of the comprehensive guarantee amount.

The stand-alone condition of “sufficient financial standing” has been removed and replaced by a more general provision, allowing that other assets, easily convertible, should also be considered to determine the financial capacity of the economic operator in the context of granting such reduction or waiver.

Besides, while applying for a guarantee reduction or waiver by an authorized economic operator (AEO), the initial conditions stipulated in article 84 UCC DA seemed to be stricter than the modalities mentioned in article 95 of the UCC, which led to a double assessment compared to the non-AEOs. The modified provision ensures this double assessment is removed.

### Take-aways for operators

Importers and exporters need to closely monitor any amendments to the UCC, UCC DA, UCC IA and, to a lesser extent, the Transitional DA. A great majority of legal dispositions regulating customs activities throughout the Union are governed by those acts.

As we have seen with the controversial definition of exporter, companies assessing their exposure to Brexit should also closely monitor any amendments to the EU customs law as part of their Brexit regulatory watch and mitigation plans. ■

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## Trade remedial actions in the steel and aluminum sector in India

The global steel and aluminum sector is facing a period of uncertainty. Increase in tariff for certain steel and aluminum products by the United States in January 2018 has catalysed cascading protectionist responses from other countries. As a result, exports of a variety of steel products to these countries have witnessed a marked decline. For instance, steel exports to the United States in 2018 declined by 49% to US \$ 372 million in year-on-year terms.<sup>1</sup> This trend, coupled with persistent overcapacity in the global steel market, has also led to increase in imports to India due to the diversion of global trade flows. Growth in import of steel products to India by 39.46% between 2016 and 2018 (Chinese imports grew by 15.46% during this period) clearly demonstrates this.<sup>2</sup>

The Indian steel and aluminum producers contend that this inflow is often at dumped prices and is causing injury to them. Recently, the Indian Steel Association, a domestic steel industry body, has alleged that Iran-based steel producers are dumping steel at predatory prices via transshipment from the United Arab Emirates ("UAE") to bypass the United States' Countering America's Adversaries Through Sanctions Act ("CAATSA") scrutiny.<sup>3</sup>

Consequently, they have sought recourse to trade remedial measures and with considerable success. Currently, India imposes anti-dumping and countervailing duties on imports of steel and aluminum products from several countries (see box). However, not all of these measures have withstood legal scrutiny. In 2015, safeguard duties were applied to imports of steel products. Later, a WTO panel "India – Certain Measures on Imports of Iron and Steel Products", ruled that these duties were inconsistent with the WTO Safeguards Agreement.<sup>4</sup> Similarly, in 2016, Minimum Import Prices ("MIP") were applied on import of certain steel products for a period of nine months. This MIP was withdrawn on 4 February 2017 due to legal inconsistencies.<sup>5</sup> In March 2019, the Indian Ministry of Steel rejected a petition by the domestic industry to re-impose MIP on steel products.<sup>6</sup>

1 Export-Import Databank, Ministry of Commerce and Industry, Government of India, available at: <https://commerce-app.gov.in/eidb/default.asp>.

2 Ibid.

3 See generally, Steel makers seek ban on steel from Iran, Economic Times (18 March 2019), available at: <https://economictimes.indiatimes.com/industry/india-goods/svs/steel/steel-makers-seek-ban-on-iran-imports/articleshow/68457101.cms>.

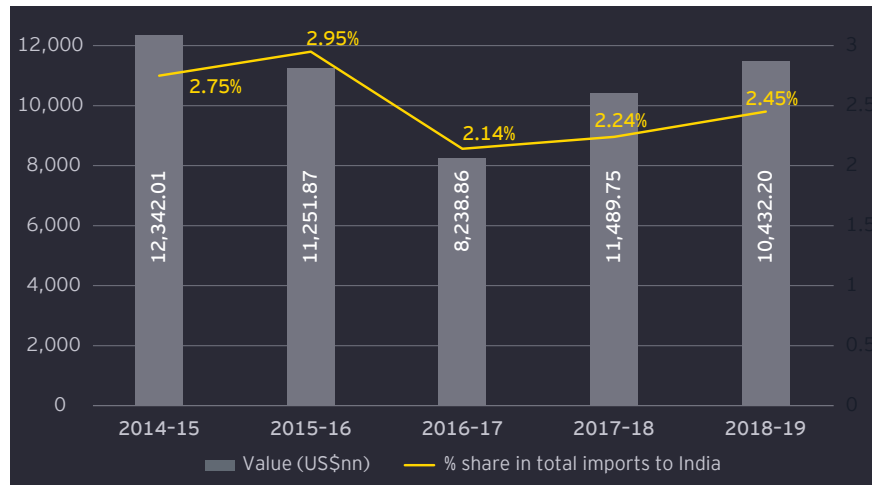
4 Panel Report, India – Certain Measures on Imports of Iron and Steel Products, World Trade Organization, WT/DS518 (9 November 2018).

5 Notifications, Directorate General of Foreign Trade, Ministry of Commerce and Industry, Government of India, available at: <https://dgft.gov.in/policies/minimum-import-primip>.

6 See generally, Ministry junks proposals for Minimum Import Price on steel as prices firm up, The Hindu Business Line (1 March 2019), available at: <https://www.thehindubusinessline.com/economy/policy/ministry-junks-proposal-for-minimum-import-price-on-steel-as-prices-firm-up/article26411834.ece>.



India's imports: steel



Source: Export-Import Databank, Ministry of Commerce and Industry

User-industry in India has opposed levy of new duties. The automobile industry has requested the removal of duty on the import of steel and aluminum products since it escalates their costs.

Currently, India's Directorate General of Trade Remedies ("DGTR") is investigating dumping of aluminum and zinc-coated flat products of steel from China, Viet Nam and South Korea based on complaint filed by the domestic industry. It is reported that the domestic industry has petitioned the DGTR to initiate a safeguard investigation to protect it from the substantial increase in imports of a wide range of steel products. However, no safeguard investigation in this regard has been initiated till now.

Given that India levies an MFN import duty of 10-15% on steel products, and 7.5%-10% on aluminum products, but it has permitted tariff-free imports from Japan and South Korea under the existing free trade agreements further complicates the trading environment.

In the light of above, likelihood of continued trade remedial actions in India remains strong.



**Anti-dumping duty (in force)**

SN	Produce	HS code	Origin	Year of imposition of duty	Rate of duty
1	Cold rolled flat products of stainless steel	7219	China, Korea, European Union (EU), Taiwan, Thailand, USA	2015	4.58%-57.39%
2	Straight length bars and rods of alloy steel	7228	China	2018	\$44.89/MT-\$185.51/MT
3	Cold rolled cold reduced flat steel products of iron or non-alloy steel or other alloy steel of all widths and thickness, not clad, plated or coated	7209, 7211, 7225 and 7226	China, Japan, Korea RP, Ukraine	2017	\$576/MT
4	Hot-rolled flat products of alloy or non-alloy steel in coils of a width up to 2100mm and thickness up to 25mm	7208, 7211, 7225, 7226	China, Japan, Russia, Korea RP, Brazil, Indonesia	2017	\$489, \$561/MT
5	Wire rod of alloy or non-alloy steel	7213, 7227	China	2017	\$535, \$546/MT
6	Seamless tubes pipes and hollow profiles of iron alloy or non-alloy steel other than cast iron	7304	China	2016	\$961.33-\$1610.67/MT
7	Hot rolled flat products of stainless steel 304 series	7210, 7219	China, Korea RP, Malaysia	2015	\$180/MT, \$309/MT, \$316/MT
8	Colour coated pre-painted flat products alloy non-alloy steel	7210, 7212, 7225, 7226	China, EU	2017	\$822/MT
9	Hot rolled and cold rolled flat products of stainless steel	7219, 7220	China	2017	18.95% *
10	Cold rolled flat products of stainless steel	7219	China PR, Korea, EU, South Africa, Taiwan, Thailand and USA	2017	4.58%-57.39% **
11	Aluminum alloy wheels	8708	China, Korea RP, Thailand	2019	0.08\$/kg-2.15\$/kg **
12	Aluminum radiators	8708	China	2017	22.89\$/unit
13	Aluminum foil	7607	China	2017	0.69\$/kg

Source: Directorate General of Trade Remedies, Ministry of Commerce and Industry, Government of India

"China" in this table refers to the mainland China jurisdiction.

\* Applicable countervailing duty

\*\*Anti-circumvention Investigation

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## South Africa to introduce anti-forestalling measures in respect of excise duties



The Tax Administration Amendment Act 22 of 2018 contains amendments to a number of Tax Acts including the Customs and Excise Act 91 of 1964 (C&E Act). One of the amendments is the introduction of anti-forestalling measures related to excise duties.

The anti-forestalling measures are contained in Section 58A of the C&E Act and are intended to prevent the practice of entering a large volume of excisable goods for home consumption in the period leading up to an expected increase in excise duties. The practice of duty forestalling, as it is called in the Act, is intended to avoid the payment of the increased rate of duties.

Section 58A intends to combat duty forestalling by limiting the quantities of excisable goods that may be entered for home consumption during a fixed period of time before an anticipated increase in the rate of excise duty.

The anti-forestalling provision prohibits a person from entering excisable goods for home consumption in excess of the quantities as determined by a formula. The Commissioner may, however, approve the entry of an excess quantity in exceptional cases.

The anti-forestalling along with the rules thereto will be applicable to both imported and locally produced excisable goods.

In order to provide for the effective administration of this section, the Commissioner of the South African Revenue Service (“SARS”) may make certain specific rules. The Commissioner may provide rules relating to the kind of goods to which the section is applicable, the controlled period, the formula for calculating the quantity and penalties.

The Commissioner of SARS has not yet published final or draft rules in terms of section 58A. The Commissioner must, however, determine, by rule, the length of the controlled period. This period is however limited to three months before an anticipated excise duty increase.

In addition to the above, the Commissioner will also have to indicate which products the anti-forestalling measures will be applied to while considering the “prevalence of duty forestalling in the particular industry”. At this stage, no indication has been given as to the scope of the measure but any excisable product may be covered including goods liable to specific and ad valorem excise duties. Excisable products in South Africa include tobacco products, alcoholic beverages, fuel, certain chemicals, cosmetics, motor vehicles and certain electronics.

The Commissioner will further have to determine the formula to calculate the number of goods that may be entered for home consumption during the controlled period. In deciding on a formula, “the average amount of entries for home consumption per product per registered importer or licenced manufacturing warehouse, calculated over a period sufficiently long to reflect seasonal fluctuations” must be considered.

The failure to comply with Section 58A read with the rules may result in the imposition of hefty penalties. These include a penalty of treble the value of the goods cleared for home consumption in excess of the relevant maximum quantity in the controlled period.

The effective date of the above anti-forestalling measures has not been announced yet. The Minister of Finance will, however, publish the effective date in the Government Gazette.

At this stage, the full impact of the anti-forestalling measures is not known due to the fact that the rules have not been published for comment. It is however clear that South Africa will limit the clearance of certain excisable goods for home consumption during specific periods. Manufactures and importers of affected goods must, therefore, ensure compliance with Section 58A when it is made effective. ■

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## Importation of samples for certification purposes in Russia

A wide range of goods (e.g., machinery, cosmetics, life science products, chemicals, electronics, etc.) are subject to certification or declaration of conformity in Russia. This requirement is aimed on ensuring safety of products in circulation and protection of consumer rights.

For imported goods certificates or declarations of conformity are required at the customs clearance. Goods cannot be released for free circulation without these documents. On the 27 February 2019 the Federal customs service of Russia together with Federal agency for consumer rights protection and human wellbeing issued clarifications on import of samples for certification and testing. It summarizes the latest practice in this regard and explains how to import samples for certification purposes.

The reason for this clarification is the historical practice of certification laboratories that made “paper” testing based on documentation without receiving samples. Therefore, they issued certificates and verified declarations of conformity without proper testing of samples. Russian customs authorities last year began a massive campaign against such inappropriate certificates by demanding protocols of sample testing. It was found out that in many cases the samples that were tested on papers were not declared. For example, they could be imported as personal belongings, or even not imported at all. To fix this issue and trace the samples, the customs authorities demanded that all samples shall be customs cleared separately and coded as samples in the declarations. It is also

mandatory that test protocols refer to customs declaration number for the samples used for such tests.

This raised a lot of practical issues and lead to massive delays in customs clearance. In the clarifications the Federal customs summarized the practical requirements to import of samples for certification. For example, there are the following requirements:

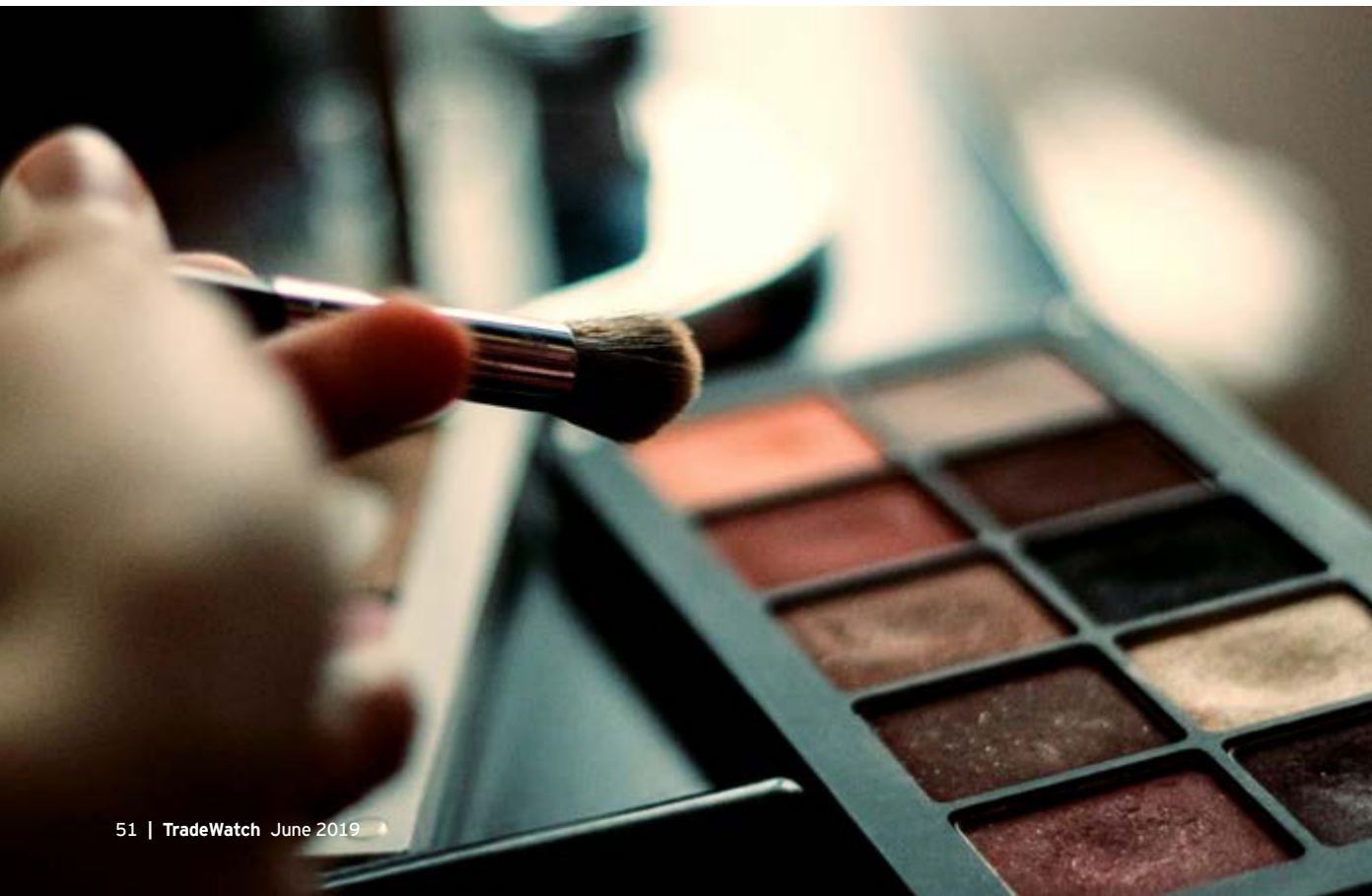
- ▶ Each certificate or declaration of conformity shall be issued after testing samples of goods.
- ▶ Samples should be declared to the customs separately from other goods. The declaration should note that the goods declared are samples for testing purposes.
- ▶ It can import samples in personal luggage, but they must be declared as imported for testing purposes (not as private belongings).
- ▶ To qualify the goods as samples the importer of record should provide customs with a contract with the certification laboratory for testing of those samples. The quantity of samples for testing should be prescribed by the laboratory in writing.
- ▶ It is not allowed to get samples for testing from stocks that are already in Russia and were customs cleared under other certificates (e.g., expired certificates).
- ▶ An importer shall pass to the certification laboratory the set of documents related to import of samples.
- ▶ Test protocols shall refer to the number of declaration under which the samples were declared. Customs can request an importer of record for a test protocol at any time. If there is no reference to the samples' declaration in the protocol, the customs do not accept the certificate and reject the release.

### Key takeaways

Companies importing in Russia should audit the certifications and declarations of conformity at hand to make sure that they conform with the rules. If not, they should be re-issued as per the above requirements. The control process for import of samples and proper testing should be established. ■

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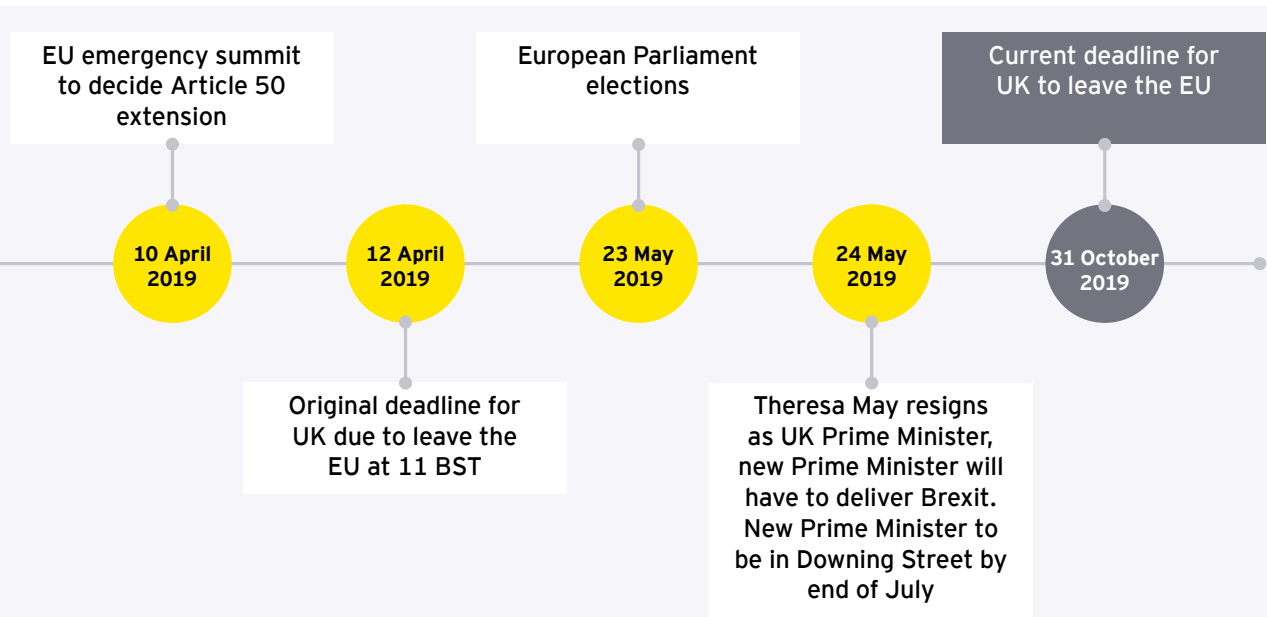
# Brexit update

A referendum on the UK's membership in the European Union (EU) was held on 23 June 2016 in which UK voters decided to leave the EU. This marks a significant change for the UK, EU and for businesses in these countries and beyond, affecting many areas of business including indirect taxes.

The UK Government invoked Article 50 on 29 March 2017, triggering the formal process to withdraw from the EU with a planned exit date of 29 March 2019.

The EU27 and UK have agreed a second extension of Article 50 to 31 October 2019. The UK can leave the EU earlier if it ratifies the Withdrawal Agreement ahead of that time.

All impacted companies should now have a Brexit plan in place for critical impacts and have triggered mitigating actions where dictated by lead times or business-critical impacts. ■



For the latest information and insights about the impact of Brexit on global trade, visit our website.



Listen to the views from our indirect tax leaders on how to prepare for Brexit:



How should businesses prepare for Brexit?



What should businesses consider to prepare for the impact of Brexit on global trade?

# Technology



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# 3D printing may be subject to customs tax

The technology of 3D printing can simplify a supply chain to two entities: a designer preparing the blueprint and the printer at the other end.

## Indirect tax and 3D printing – will customs start taxing technology?

The advancement of 3D printing has been heralded as one of the major disruptive trends affecting industries such as automotive, medicine and even film. With more 3D printing application in the manufacturing sector, the potential ripple effects on the supply chain are now starting to emerge and gain greater notice.

## Impact of 3D printing on the supply chain

3D printing refers to a manufacturing process whereby a product is assembled by layering materials under programmed commands. Products can be of almost any structure or geometry and are produced from digital data blueprints.

Pushing this technology to the maximum extent, it has been and can be postulated that 3D printing can simplify a supply chain to just two entities or people – a designer at one end preparing the blueprint, and the printer or “manufacturer” at the other, preparing the final product using a 3D printing device. Intermediaries in the supply chain will most likely be the suppliers of raw materials required to produce the product.

This means an elimination of multiple supply chain stages, thereby providing lower production costs, reduction of finished goods inventory levels; greater levels of product customization available for customers; faster speed to market and first-entrant advantage; and overall improvements in customer service. There will be a redefinition of lean manufacturing and noticeably less cross-border physical trade flows.

## Impact of less cross-border physical trade flows

The decrease of physical trade flows can be another additional source of cost reduction for companies – lower customs duty, import tariffs and excise duty payments, as well as reduced administrative burden in terms of license, permit applications and standards confirmation.

While companies may rejoice, customs authorities may not. Particularly in Asian and other less developed countries e.g., the Philippines, where customs authorities (and the government) often depend on customs and value-added tax (VAT) earnings for their wages and bonuses, this trend is unlikely to pass unnoticed.



As noticed in the parallel development of Base Erosion Profit Shifting (BEPS), and in times of economic austerity, governments are cognizant of reducing tax bases and will carry out actions to shore them up. Similarly, it is not inconceivable that customs authorities and governments will take note of their dwindling revenue and turn their attention inward.

The issue with 3D printing is that while there would be less cross-border flows of tangible goods (with only raw materials or components required for use in 3D printers), technological intangible products (in this case the blueprint of the product to be printed) would have to cross borders from where they were designed to the multiple locations where they would be printed.

### **Is technology part of the value of a product?**

With a flat supply chain, the digital data blueprint will thus increasingly take up a greater portion of the value of a product, which in the past would be fully taxed by customs when passed through the border as a physical product.

As a result, local tax and customs authorities may look to replace lost tax revenue by taxing the digital or intangible service flow and put such companies utilizing 3D printing supply chains (and those of similar working nature) under greater scrutiny.

### **Would imported technology thus be subjected to taxes and regulations?**

Some countries have already quietly begun this process. In February 2018, Indonesia issued a regular amendment providing for a new addition of Chapter 99 to the Indonesian tariff system. Chapter 99 covers intangible products including software and other digital goods transmitted electronically not related to machines or devices to be imported.

These digital goods include operating system software, application software and multimedia, etc. Currently the tariffs on these Chapter 99 products are 0%. However, there is always the possibility that the tariffs could increase.

In January 2019, Argentina imposed export duties on exports of services at a rate of 12% with a maximum limit of four Argentina pesos per US dollar of the amount arising from the invoice or an equivalent document. This duty will be in effect until 31 December 2020. The government had introduced these duties due to the need for greater tax collection and the significant increase in exchange rate of the US dollar vis-à-vis the Argentine peso during 2018.

### **How long would it take for more countries to decide that customs taxation is relevant on the intangible technology being imported into the country?**

We believe that this is a matter of time, especially looking at the current focus of the international tax and customs community. Driven by the Organisation for Economic Co-operation and Development, more than 100 countries are embarking on implementing the BEPS Action Plan, including Action 8, transfer pricing on intangibles.

Given the long-term discussion on the relationship between customs valuation and transfer pricing over the last few years, with the business community advocating that customs consider the impact of transfer pricing adjustments on the customs value of imported products, it is likely that the conclusion of Action 8 implementation by the various countries will lead to commensurate changes in the business communities' customs and VAT strategies, as well as the corresponding regulations by both national and international governments.

Given these likely future developments, governments and companies must keep abreast of technology trends, as well as changing direct and indirect tax regimes, to navigate the unknown. Critically, the ability to take a wider, holistic and integrated view of cross-disciplinary functions of transfer pricing, tax, indirect tax and supply chain will be vital when charting a company's journey to growth in the near and medium-term future. ■

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# Using data analytics for Philippine customs audit

**The Philippine government issued Customs Administrative Order (CAO) No. 01-2019 which provides among others the procedure and methodology for the conduct of a Post Clearance Audit (PCA) of registered importers. Accordingly, importers need to be audit-ready in the event that the Bureau of Customs (BoC) conducts a PCA.**

Audit readiness can be achieved by conducting a Customs Health Check or a Customs Compliance Review (CCR) to identify areas of risk and potential exposures prior to a PCA, to ensure that importation records are complete, and to enable the importer to determine the issues and amounts for a possible availment of the BoC's Prior Disclosure Program (PDP). This program is an option available to importers to voluntarily disclose errors in good declarations and pay deficiency duties, taxes, and other charges that may arise in lieu of a full audit.

Given the limited time for importers to be ready for a customs audit – which can occur at any moment – or to consider to do a prior disclosure, how can this be done?

Data analytics offers an alternative and possibly, a more efficient approach to audit readiness.

## **Defining 'data analytics'**

Data analytics is the application of tests on information that is electronically available, either

from the company's Enterprise Resource Planning (ERP) systems or through brokers' database and other digital sources. The aim is to identify key focus areas which uncover risks and opportunities, while also providing basis to make strategic decisions over core processes and compliance activities. In doing so, data analytics can help allocate resources to areas of highest saving potential, or for risk mitigation.

Data analytics can be used to perform the following:

1. Identify errors in order to take appropriate actions to minimize exposure
2. Discover potential tax and cash flow savings, and tax recovery opportunities
3. Detect process inefficiencies or risks, as well as consider opportunities to remove inherent risks, and
4. Provide management insight to help address the company's key trade and value-added tax (VAT) concerns and priorities

## **The role of data analytics in a PCA**

The insights gleaned from an importer's electronic data could be used to identify customs and trade-related risks, issues with noncompliance, and financial exposures. The use of this information will facilitate an accurate and timely disclosure to the BoC, and even to the Bureau of Internal Revenue (BIR).



By using available digital data, importers may also avoid resource constraints such as lack of manpower, or the tedious task of manual vouching importation documents. This will also minimize risks of error and oversight that come with purely manual processes. There is also ample possibility of testing 100% of all import transactions, which is preferable to just a sampling. The process involved with data analytics will provide instantaneous multilevel perspectives, allowing an importer to make informed decisions supported by evidence.

Some examples of core tests involving trade analytics include:

- ▶ **Import overview** – This allows for a quick, “get a sense” of the business, as it illustrates total customs value, duties, or VAT paid, per year, month, or day. It could diagnose unusual dips or increases from the expected or average amounts, allowing the company to investigate the underlying import transactions which may have caused them.
- ▶ **Duty analysis** – This creates a pictorial identification of the duty rates paid by the importer, which could show potential variations in duty rates used for similar products. Duty analysis may be able to show product groups with more than one distinct Tariff Classification, which could indicate if one or more products are being incorrectly classified.
- ▶ **Incoterms** – The Incoterms (or the International Commercial Terms) are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) relating to international commercial law. Trade analytics can identify suppliers using multiple Incoterms which may be contrary to those agreed or desired. Additionally, analytics may point out risks on the use of Ex-Works, that could give rise to findings of underpayment of duties and taxes since customs values should be based on Free on Board (FOB) or Free Carrier At (FCA) value. Ex-Works is an international term by which a seller makes the product available at a designated location, and the buyer incurs transport costs.

- ▶ **Free Trade Agreement (FTA) usage and opportunities** – This would identify where FTAs have been utilized and thus, would point out a need to provide documentation to support the lower duty rate used on specific imports. It will also help identify where FTAs are available (but not currently utilized) to help save costs.
- ▶ **Related party transactions** – Analytics may also identify anomalies in related party transactions against unrelated parties.
- ▶ **Physical supply chain** – This will identify unusual or inefficient routes, and the value or weight and method of transportation used.

Importers also have the option to perform customized tests to compute total landed cost for importations per month, quarter, and year. This will address the question on whether the landed cost per VAT returns tallies with landed cost per the BoC’s summary of importations. Tests can also be devised to compute for the correct customs duties and taxes per import entry, to determine any possible underpayment that may be considered for a voluntary disclosure.

Since a PCA covers three years of importation (potentially involving thousands of importations), but only provides a limited time of 15 days to respond to findings of noncompliance and/or assessment of underpaid duties and taxes, it is vital that importers take every available measure to be audit-ready. If applicable, they should also consider the benefit of the PDP.

A PCA may result in heavy consequences for importers, since penalties during a PCA range from 125% to 600% of the revenue loss to the Government, depending on the degree of culpability. Upfront disclosure may bring significant material savings to affected importers.

With the recent issuance of Customs Administrative Order (CAO) No. 01-2019, it is expected that the BoC will intensify PCAs and issue numerous ANLs. Thus, unprepared importers may face steep penalties, interests and surcharge on noncompliance. This is why the BoC is encouraging importers to seriously consider the PDP.

In this age of information technology, it will be most prudent to consider harnessing the power of data analytics to sift through and utilize all information that may just be sitting dormant in the company’s database and systems. ■

**If you have any questions or specific concerns relating to those discussed above, or with any indirect tax issue for that matter, you may kindly reach out to EY Philippines’ Indirect Tax Partners/ Principals below:**

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# Tax Alerts

Tax Alerts

## Americas

**Brazil**

- ▶ Brazilian Federal Revenue changes procedures applicable to special customs regimes for oil and gas industry (25/04/2019)

**Canada**

- ▶ USTR announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US (26/06/2019)
- ▶ Canada imposes final safeguard measures on imports of heavy steel plate and stainless-steel wire: update (23/05/2019)
- ▶ Canada and US agree to remove tariffs and retaliatory surtaxes on steel and aluminum imports (22/05/2019)
- ▶ Finance Canada announces intent to enact final safeguards on imports of heavy plate and stainless-steel wire (09/05/2019)
- ▶ Canadian International Trade Tribunal releases safeguard inquiry report regarding certain steel goods (16/04/2019)
- ▶ Federal budget 2019-20 (19/03/2019)
- ▶ Canada Border Services Agency to increase amounts for Administrative Monetary Penalties effective 1 April 2019 (15/03/2019)

**Costa Rica**

- ▶ Costa Rica announces proposed changes to General Customs Law Regulation (14/06/2019)

**Mexico**

- ▶ USTR announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US (26/06/2019)
- ▶ Local content percentage for automotive parts increases to 40% under Economic Complementation Agreement No. 55 between MERCOSUR and Mexico (20/03/2019)
- ▶ US pauses implementation of sweeping tariffs on Mexico, approves new exclusions for certain products from Section 301 tariffs on imports from China (10/06/2019)

**US**

- ▶ USTR announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US (26/06/2019)
- ▶ US pauses implementation of sweeping tariffs on Mexico, approves new exclusions for certain products from Section 301 tariffs on imports from China (10/06/2019)
- ▶ US announces new import tariffs on Mexico, delays tariff increase on certain China goods and formalizes removal of India from GSP (03/06/2019)
- ▶ Huawei and affiliates added to the Bureau of Industry and Security's Entity List effectively barring US exports to the company (22/05/2019)
- ▶ Canada and US agree to remove tariffs and retaliatory surtaxes on steel and aluminum imports (22/05/2019)

- ▶ US takes certain actions on Section 232 Automotive and Metals tariffs; Permanently removes Turkey from GSP eligibility (20/05/2019)
- ▶ USTR initiates actions to implement up to 25% tariffs on remaining products from China under Section 301; China retaliates with its own tariffs against most recent actions (15/05/2019)
- ▶ USTR publishes fourth round of exclusions for Chinese-origin products; issues initial denials for next set of product requests (13/05/2019)
- ▶ US announces increase of tariffs on List 3 goods imported from China (08/05/2019)
- ▶ USTR publishes new exclusions for Chinese-origin products (19/04/2019)
- ▶ USTR proposes retaliatory tariffs on 326 products as countermeasure to EU subsidies (10/04/2019)
- ▶ US grants additional tariff exclusion status to limited set of imports from China (25/03/2019)
- ▶ Pair of economic studies estimate the impact of US import and foreign retaliatory tariffs on US economy (15/03/2019)
- ▶ US suspends planned increase of duties on certain Chinese origin imports "until further notice"; Moves to remove India and Turkey from preferential trade benefit (06/03/2019)

## Asia-Pacific and Japan

### China

- ▶ US pauses implementation of sweeping tariffs on Mexico, approves new exclusions for certain products from Section 301 tariffs on imports from China (10/06/2019)
- ▶ US announces increase of tariffs on List 3 goods imported from China (08/05/2019)
- ▶ USTR publishes new exclusions for Chinese-origin products (19/04/2019)
- ▶ US grants additional tariff exclusion status to limited set of imports from China (25/03/2019)
- ▶ US suspends planned increase of duties on certain Chinese origin imports "until further notice"; Moves to remove India and Turkey from preferential trade benefits (06/03/2019)

### New Zealand

- ▶ New Zealand GST on low value imports to apply from 1 December 2019 (14/06/2019)

### Philippines

- ▶ Philippines grants tax amnesty on delinquencies (14/03/2019)

### Sri Lanka

- ▶ Sri Lanka releases 2019 budget proposals (29/03/2019)

### Taiwan

- ▶ Taiwan issues amendments to free trade zone provisions (18/03/2019)

## Europe, Middle East, India and Africa

### Belgium

- ▶ New procedure for cross border bunkering between the Netherlands and Belgium (11/04/2019)

### Bulgaria

- ▶ Amendments to Excise Duties and Tax Warehouses Act now in force (20/06/2019)

### East Africa

- ▶ East African Court of Justice rules goods brought into Uganda from EAC Partner States are not imports (02/04/2019)

### EU

- ▶ USTR proposes retaliatory tariffs on 326 products as countermeasure to EU subsidies (10/04/2019)

### Gibraltar

- ▶ Gibraltar announces 2019 budget (11/06/2019)

### India

- ▶ USTR announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US (26/06/2019)

- ▶ US suspends planned increase of duties on certain Chinese origin imports "until further notice"; Moves to remove India and Turkey from preferential trade benefits (06/03/2019)

### Kenya

- ▶ Kenya presents 2019/20 budget statement (17/06/2019)
- ▶ Kenya's High Court reiterates importance of proper processes and procedures in taxation (27/03/2019)

### Netherlands

- ▶ New procedure for cross border bunkering between the Netherlands and Belgium (11/04/2019)

### Pakistan

- ▶ Punjab Budget Briefing 2019 (16/06/2019)

### Saudi Arabia

- ▶ Saudi Arabia announces excise tax changes (22/05/2019)

### South Africa

- ▶ South Africa publishes draft rules for collection and administration of Carbon Tax for public consultation (03/05/2019)

### Turkey

- ▶ Turkey amends customs law to prevent to remove exemption threshold for certain imported goods (18/06/2019)
- ▶ Turkey amends certain provisions of the Customs Regulation (14/06/2019)
- ▶ US suspends planned increase of duties on certain Chinese origin imports "until further notice"; Moves to remove India and Turkey from preferential trade benefits (06/03/2019)

### Uganda

- ▶ East African Court of Justice rules goods brought into Uganda from EAC Partner States are not imports (02/04/2019)



# Additional resources



## Global trade disruptors

Trade continues to make headlines globally. For many organizations, keeping up with the current evolving state of trade is proving difficult – particularly since change seems to be a daily occurrence. This electronic magazine provides the latest global trade-related news to help you stay informed and able to adapt in a fluid trade environment.

[Find out more](#)



## 2018 EY Global Trade Symposium report

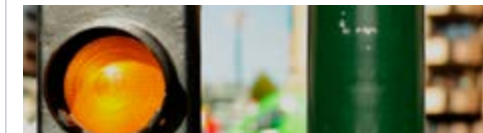
Is trade the disruptor or the disrupted?

[Find out more](#)



## ey.com TradeWatch archive

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## Brexit: read our latest analysis

As Brexit uncertainty continues, read our latest analysis and probabilities and consider how to mitigate the impact and prepare your business.

[Find out more](#)

Additional resources



## Worldwide Indirect Tax Developments Map

The Worldwide Indirect Tax Developments Map is designed to help you keep abreast of indirect tax changes around the world. It provides a brief outline of what is happening, and where and when the changes take place along with links to find out more.

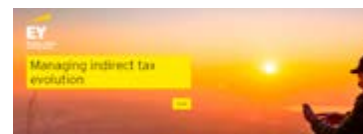
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## Indirect tax on ey.com

While indirect tax is a part of everyday life in most countries, the rise of new technologies and expanding global trade adds additional layers of complexity. Learn what EY can do for you, connect with us or read our latest thinking.

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## Managing indirect tax evolution

Our new Global Indirect Tax thought leadership report, sets out why indirect tax is becoming the “go-to” tax.

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