

TradeWatch



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New Harmonized System 2022 edition: Preparing for change

On 8 January 2020, the World Customs Organization (WCO) announced that the seventh edition of the Harmonized System, HS 2022, had been accepted by 158 Contracting Parties¹ to the Harmonized System Convention, and would come into force on 1 January 2022.

The Harmonized System (HS) comprises about 5,000 commodity groups, each identified by a six-digit code, arranged in a legal and logical structure by well-defined rules to achieve uniform classification. Essentially, it is a system or tool used by customs authorities and businesses across the world to identify and classify trade products in a standardized manner. This allows both authorities and taxpayers to assess liability with respect to duties and taxes. In addition, and among others, tariff classification of products has an impact on origin management and import and export restrictions may be used to gather information for trade statistics.

At the time of publication of the current HS 2017, a general review of the HS had already begun, taking into account the emergence of new products and ways in which the HS may be improved or clarified. Based on these considerations, amendments to the HS were drafted, made up of the inclusion and deletion of headings and subheadings and the

addition of definitions, and the Contracting Parties were given six months to indicate any objections. At the end of the six-month period, having received no objections, the amendments were deemed to have been accepted for implementation under HS 2022.

Amendments to the Harmonized System

In an ever-changing world, marked by changes in technology and patterns of international trade, it is important that the HS be kept up-to-date and that any amendments be made in accordance with the needs of industry.

For example:

- ▶ Currently, smartphones may be accurately classified under a subheading for “*telephones for cellular networks or for other wireless networks*”. However, under the HS 2022, a new – more specific – subheading has been introduced for smartphones, i.e., subheading 8517.13 (see table opposite)

¹ As at 21 February 2020 there were 212 countries, territories or customs or economic unions applying the Harmonized System, 159 of which are Contracting Parties.

² In terms of new Note 5 to Chapter 85, for the purposes of heading 85.17, the term “smartphones” means telephones for cellular networks, equipped with a mobile operating system designed to perform the functions of an automatic data processing machine, such as downloading and running multiple applications simultaneously, including third-party applications, and whether or not integrating other features such as digital cameras and navigational aid systems.



HS 2017	HS 2022
85.17	
<ul style="list-style-type: none"> ▶ Telephone sets, including telephones for cellular networks or for other wireless networks ▶ Telephone sets, including telephones for cellular networks or for other newtorks 	
8517.11 Line telephone sets with cordless handsets	8517.11 Line telephone sets with cordless handsets
8517.12 Telephones for cellular networks or for other wireless networks	8517.13 Smartphones ²
	8517.14 Other telephones for cellular networks or for other wireless networks

- ▶ HS 2022 also includes new heading 88.06 for unmanned aircraft. This covers products commonly known as drones and are defined in the explanatory notes as any aircraft designed to be flown without a pilot onboard; not to be confused with flying toys, designed solely for amusement purposes.

Notably, the first true smartphone made its debut in 1992, and the earliest unmanned aerial vehicle in the history of drones was seen in 1839, making the inclusion of 8517.13 and 88.06 into the 2022 edition of the HS seem anything but “up-to-date.” This highlights a critical point relating to tariff classification: All products can be captured within the HS, even though the HS code does not provide specific wording in the heading. This is just one of the reasons why product classification per the Harmonized System can be challenging, as many products do not fit neatly into a specific description.

A further example is where products appear to be classified under two or more HS codes. For those who are not familiar with the process of tariff classification and its inherent complexities, an HS code will be selected based on preference, i.e., what seems to fit the product or what attracts the lowest duty rate, rather than the HS code under which the product *must* be classified. This approach is wrong and may be deemed an offense under customs law. Products must always be classified under the appropriate and correct HS code.

Managing tariff classification

The HS constitutes a set of headings and subheadings that together with the General interpretative rules and section, chapter and subheading notes provide for the uniform classification of goods, a process which is often complex and is the subject of many disputes between importers and customs authorities.

For this reason, it is common for companies to use external service providers, e.g., customs brokers, to perform their product tariff classification. This is presumed to be a more efficient process, especially where the customs broker has already been tasked with filing the import and/or export declaration. On the other hand, companies also use external service providers because they do not have in-house expertise, a function often overlooked.

While outsourcing is not necessarily bad practice, companies must not abandon their duty to ensure that their products are correctly classified. To abandon such duty exposes companies to errors and customs penalties, which becomes increasingly likely where companies rely solely on their customs brokers, who are often flooded with import and export declarations.

Therefore, ahead of 1 January 2022, importers, exporters and manufacturers alike must ensure that their customs functions – be it in-house expertise or external service providers – familiarize themselves with the amendments introduced by HS 2022, particularly those that may have an impact on the

company’s product portfolio and master data set. All necessary steps must be taken to ensure timely adherence to the changes to avoid delays in trade activities and potential punitive action being taken by customs authorities.

Preparing for the HS 2022 edition

As published by the WCO, the HS 2022 includes a total of 351 sets of amendments. These amendments affect several sectors,³ including agriculture, food, tobacco, chemical, transport and electronic goods.

Within the various sectors, it is expected that a number of companies will be impacted, all of whom need to begin the process of preparing for the implementation of HS 2022.

This can be done through a number of ways, including:

- ▶ In-house expertise
- ▶ External service providers, including tax consultants and customs brokers
- ▶ Customs authorities

In-house expertise and external service providers

A common theme across all customs jurisdictions is the importance of sufficient knowledge of customs procedures, including tariff classification. Importers and exporters need to understand that the responsibility of the correct classification rests with

³ The sectors affected by the amendments may be divided as follows: agricultural, food and tobacco, chemical, wood, textile, base metal, machinery and electrical goods, transport, and other.

them, which includes staying abreast of all changes made to the HS and at a national/domestic level.

Further to this, and important to tariff classification, is knowing what the product is. Before applying any of the chapter and subheading notes, or general interpretative rules, you have to have a good understanding of the nature of the product, how it is manufactured and any technical characteristics. This product knowledge, often found in-house, feeds into the process of classification, thus facilitating tariff classification performed by either in-house expertise or external service providers.

Customs authorities

Within the ambit of global trade analytics, the use of HS codes is often examined, whether it is consistency between shipments or the presence of different HS codes by the same description. Customs authorities are also very focused on HS classification as an issue under audit and now use tools that historically were not available to them.

Coupled with the implementation of HS 2022, the focus on HS classification has therefore never been more important, making it imperative for companies to get it right. One way of doing so is through tariff rulings. Tariff rulings may be obtained from the customs authorities in many countries. The timeframe within which rulings are issued and their period of validity differs from country to country, but as a rule, formal rulings give the importer the legal assurance of their product classification in the country where the ruling was obtained. Advance rulings will therefore assist companies in preparing

for the implementation of HS 2022, and further, may be used as support during a customs post-clearance audit.

Important to note for both companies and governments, is that the introduction of new HS codes under HS 2022 may result in existing HS 2017 tariff codes being wrong after the date of implementation; but also, it presents an opportunity to address and correct any prior HS errors.

What happens on the date of implementation?

As mentioned, the anticipated date for implementation is 1 January 2022, a mere 18 months away. Now is the time to address any errors and gain clarity on how products will be classified under HS 2022. During this period, companies also need to ascertain the date when their customs authority will implement HS 2022.

With respect to previous editions of the Harmonized System, it is important to note that notwithstanding the WCO published date of implementation, not all countries migrated to HS 2017 by date of coming into force, i.e., 1 January 2017. Indeed, Vietnam is an example of a country whose customs authority did not immediately implement HS 2017. During June 2017, Vietnam Customs issued the list of imported and exported products under HS 2017, which subsequently came into effect on 1 January 2018.

Having regard to the historical position, HS 2022 might therefore not be adopted by all countries on 1 January 2022. To avoid any potential stumbles, companies should only update their SAP systems and master data set where the customs authority has adopted HS 2022 and has amended the HS codes on a national (domestic) level.

Conclusion

With less than two years until the implementation of the 2022 edition of the HS, on 1 January 2022, customs authorities have taken a proactive approach in preparing amendments to its domestic HS codes, to bring it in line with the HS amendments published by the WCO. So too, companies need to begin the process of preparing for the changes that may impact existing product portfolios. All rulings currently in place will also need to be reviewed to determine whether they will remain valid post implementation. ■

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Why trade disputes are reshuffling supply chains and transfer pricing

COVID-19 and trade disputes are disrupting global supply chains and compounding the geopolitical risks facing businesses. Find the article on [ey.com](https://www.ey.com). ■





Why the global trade function means more than moving goods from A to B

Executed well, a good trade function doesn't just function – it delivers tangible benefits across the business. Find the article on [ey.com](https://www.ey.com). ■

Brazil: Supreme Court rules the Siscomex fee increase unconstitutional and makes refunds

On 28 April 2020, the Brazilian Supreme Court (STF) confirmed the unconstitutionality of the increase of the Siscomex fee enacted by the Ministry of Finance, which applied a readjustment percentage that exceeds the official indexes. Extraordinary Appeal #1.258.934 was adjudicated through "general repercussion," which means that the finding must be observed by all Brazilian courts.

In this context, there is an opportunity for importers to file claims to recover amounts overpaid in previous years.

What is the Siscomex fee?

The Siscomex, or Integrated Foreign Trade System, is a system managed by the Brazilian Federal Revenue that enables the operationalization and control of foreign trade transactions in Brazil. By way of this system, importers and exporters register all import and export declarations to qualify for the customs clearance procedures.

In case of imports, registering an Import Declaration (DI) requires the payment of a charge called the Siscomex fee. This fee is considered as a tax for Brazilian legal purposes. The Siscomex fee was instituted by the Federal Law #9.716/1998 and its previous amount was BRL30.00 per declaration, plus BRL10.00 for each addition of goods.

In May 2011, the Brazilian Ministry of Finance, through the enactment of the Normative Act MF #257/2011, increased the Siscomex fee to the amount of BRL185.00 per DI, plus BRL29.50 for each addition of goods. The increase represented a readjustment of more than 500% when compared to the previous fee. It is this increase that the STF determined to be unconstitutional.

What next?

The Brazilian Supreme Court application of general repercussion makes it clear that importers may claim

a refund of overpayments for the past five years. Nevertheless, the amount that may be reclaimed remains subject to two questions:

- ▶ The first question is whether some degree of reasonable readjustment rate should be applied to the Siscomex fee established in 1998?
- ▶ The second question is how much?

The Brazilian Federal Revenue, which is responsible for regulating the effects of the decision, has not yet published a Normative Act on how taxpayers should proceed after the general repercussion. However, importers should be prepared and able to act as soon as possible, as the expectation is that a Normative Act will be published by the Brazilian Federal Revenue in the coming weeks. Importers will want to act as quickly as possible to avoid claims beyond the five-year statute of limitations. Brazilian importers are well advised to start calculating the potential refund on overpaid amounts and devise a clear strategy on potential scenarios to recover it. ■

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US-China trade tariff mitigation strategies remain critical for companies in turbulent times



Trade relations between two of the world's largest economies, the United States (US) and China, have become increasingly turbulent over the last four years. In 2016, President Trump and his Administration ratcheted up tensions by immediately taking a hawkish approach to directly addressing key trade issues with China. The Administration firmly believed that China was taking advantage of the US on multiple trade matters, including intellectual property (IP) infringement and a trade imbalance perceived to be harming the US interests, and made clear the intention to force needed changes.

Subsequent actions, which included studies reflecting the Administration's point of view ensued. Much of 2018 and 2019 saw on and off negotiations, with reactive duties implemented by both sides. This created significant disruption and potential economic growth harm to both parties.

The beginning of 2020 began with some easing of trade tensions, a result of comprehensive negotiating sessions late in 2019. The series ultimately culminated with the signing of the Economic and Trade Agreement between the Government of the United States of America and the Government of China (the Agreement or Phase One).

The hard-fought commitments made between the two parties only addressed certain concerns, and while the US paused further implementation of additional punitive tariffs, and even reduced punitive tariffs for certain products already in effect, it retained the punitive tariffs on the majority of China origin goods.

However, trade disruption triggered by the COVID-19 pandemic has strained tensions, and potentially the ability of China to meet the previously agreed-upon commitments. These commitments involved significant increases in year-over-year commodity and product categories, including key farm and energy sectors. Amid increased political tensions surrounding the global economy decline and China's handling of the pandemic origin, there is growing risk that any further trade agreement phases or reductions to the current punitive tariffs may fade, and potential risk ultimately of either party withdrawing from the Agreement itself.

In this ever-evolving and turbulent environment, global traders with imports and exports between the two countries should continue exploring and implementing ways to mitigate the increased duty payments and potential for additional barriers that may arise.

Ongoing relief: product exclusions

The Phase One Agreement addresses many non-tariff barriers to entry for US companies, as well as longstanding concerns about doing business within China, such as China's commitment to increase purchases of US goods and services in the next two years. This includes US manufactured goods,

food products, agriculture and seafood products, and energy products and end technology transfer conditions required for market access.¹ However, the Agreement did not address all of the US items of concern, such as cyber intrusions and state-owned enterprise disciplines.

The Agreement does not address the current tariffs that remain on both the majority of Chinese-origin goods imported into the US and those imposed on a significant amount of US-origin goods imported into China.

These tariffs continue to be a financial burden on US and Chinese importers alike, and companies continue to search for ways to effectively reduce, avoid or defer the high duty payments.

US exclusions continue

One method US importers have turned to for duty relief on Chinese origin goods subject to duties under Section 301 of the Trade Act of 1974 (Section 301) is the product exclusion process.

The Section 301 tariffs were implemented in four tranches, beginning in 2018 and pausing in 2019:

- ▶ **List 1:** 25% punitive tariff covering \$34b worth of Chinese origin goods²
- ▶ **List 2:** 25% punitive tariff covering \$16b worth of Chinese origin goods³
- ▶ **List 3:** 25% punitive tariff covering \$200b worth of Chinese origin goods⁴
- ▶ **List 4:** initially broken into two sections, List 4A and List 4B, only List 4A is currently in effect, with a 7.5% punitive tariff covering \$115b worth of Chinese origin goods⁵

Following the various actions of punitive tariffs applied to Chinese origin goods under Section 301, the US Trade Representative (USTR) provided an opportunity for US stakeholders to request the exclusion of specific products classified within an eight-digit Harmonized Tariff Schedule of US (HTSUS) subheading covered by each of the four tranches by establishing formal exclusion request processes.

After review of each exclusion request was completed, the USTR issued a denial or a grant, at its discretion, based upon specified criteria and facts presented by the submitted request. Under this process, the USTR then published formal determinations of all granted HTSUS numbers and product descriptions for awareness to the trade community.

The below table details the product exclusions granted to date:

	Total requested	Granted	% Granted*	Denied	% Denied*
List 1	10,814	3,656	33.78%	7,158	66.22%
List 2	2,869	1,074	37.43%	1,795	62.57%
List 3	30,283	1,497	4.94%	28,786	95.05%
List 4	8,781	167	1.90%	0	0%

**Note: Exclusion requests for List 4 are still pending review from CBP and percentages in chart will not be complete*

The exclusions granted are only applicable for a finite period of time. Granted exclusions for List 1 and List 2 were effective for one year from the date of publication of each of the granted exclusion announcements. List 3 and List 4, however, remain in effect for one year from the date of publication of the first exclusions pertaining to the tranche, regardless of subsequent publication dates.

On 1 November 2019, the USTR sought public comment regarding the possibility of extending the product exclusions granted under the December 2018 FRN for a period of up to 12 months. The USTR noted the following criteria should be included in public commentary to assist them in assess the extension:

- ▶ Whether the particular product and/or a comparable product is available from sources in the United States and/or in third countries

¹ See, "Economic and Trade Agreement between the Government of the United States of America and the Government of China."

² See 83 FR 28710.

³ See 83 FR 40823.

⁴ See 83 FR 26930.

⁵ See 84 FR 45821.



- ▶ Any changes in the global supply chain since July 2018 with respect to the particular product, or any other relevant industry developments
- ▶ The efforts, if any, the importers or US purchasers have undertaken since July 2018 to source the product from the United States or third countries

The USTR has subsequently requested comment from the public on the various exclusions as the expiration dates approach.

It should be noted that not all previously granted exclusions will be granted extensions by the USTR, and that some exclusions may undergo modifications. Companies should stay vigilant in reviewing exclusions to understand any impact changes may have to their operations.

China enacts new exclusion process

Similarly, China has in place an exclusion process for US origin goods subject to punitive duties.

On 18 February and 24 February 2020, China's Customs Tariff Commission ("Commission") issued two announcements⁶ regarding the market-based procurement exclusion process for goods imported from the US. The goods under consideration were those goods that had been previously subject to additional duties triggered by China's countermeasures taken in response to the US Section 301 actions. The announcement provided

6 "Announcement with respect to Exclusion Process for Market-based Procurement Products imported from the United States and Canada" under Customs Tariff Commission Announcement 2020 No 2, 17 February 2020 and "Announcement with respect to Customs Clearance Process for products imported from the United States and Canada that are subject to Exclusion Process for Market-based Procurement" under Customs Tariff Commission Announcement 2020 No 36, 24 February 2020.

a list of eligible goods by description of 696 distinct tariff numbers.

Products included on the list cover mainly agricultural, energy and manufactured products, which were deemed to be consistent with the scope of China's commitment to increase procurement of US origin goods under the Phase One agreement. The announcement provided an application mechanism for Chinese companies or enterprises within China to request a formal exclusion grant that meets the program requirements. China's Ministry of Finance began accepting applications as of 2 March 2020. Unlike the overall US exclusion process, China's Ministry of Finance is providing its decision on items covered by the current list to the requestor only.

Previously, the Commission has granted two rounds of product exclusions under the previously announced process covering all or part of the products classified under 81 8-digit tariff codes.

The new market-based procurement exclusion process has notable differences with the previous process:

- ▶ The new process is applicant-based, specific to a set amount of "purchase plan." In contrast, the previous process was product-based.
- ▶ All enterprises in China that plan to purchase and import the relevant goods from the US are eligible.
- ▶ Application results will not be public, and the granted approval is only applicable to the applicant.

- ▶ Applicants may include items that are not on the eligible goods list or the previously announced product exclusion list in the application, subject to certain conditions.
- ▶ Under the new process, duties paid on past import transactions cannot be recovered.

Mitigation actions

Since the commencement of the trade dispute between the US and China, companies have considered ways to mitigate the costly impact of increased duty payments of the punitive tariffs. These options have generally included the following actions:

- ▶ Reviewing contracts with suppliers and with customers to understand who has liability for increased duties and if there are opportunities for negotiation
- ▶ Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs, alternative sourcing options, alternative manufacturing options, including relocation of production outside of China, and to assess any opportunities to mitigate impact such as country of origin planning to address potential increases in Section 301 tariffs
- ▶ Identifying strategies to defer, eliminate or recover the excess duties paid under Section 301, such as bonded warehouses, foreign trade zones, duty drawback, Chapter 98 and equivalent programs under China customs regulations
- ▶ Exploring strategies to minimize the customs value of imported products subject to the

additional duties under either Section 301 tariffs, re-evaluating current transfer pricing approaches, and for US imports, considering US customs strategies, such as first sale for export

- ▶ Consideration on current transfer pricing of imported products, keeping in mind the importance of alignment of the income tax transfer price with the customs value to avoid inventory basis limitations under US Internal Revenue Code Section 1059A
- ▶ Evaluating whether imported goods meet the exclusion requests granted by customs authorities and seek duty refunds. In the US, considering preserving duty recovery eligibility for import transactions that are potentially subject to pending Section 301 exclusion requests. In addition, determining whether to provide comments on the granted Section 301 exclusions that are about to expire, as well as considering business impact in the event a company has benefited from an exclusion that is not extended

What's next?

While trade tensions began to ease with the signing of Phase One, the recent global economic impact caused by COVID-19 has sparked new strains on the relationship between the US and China.

Specifically, concerns have been raised around whether China will fulfill certain buying commitments pursuant to the Agreement, given the financial impact of COVID-19 that many countries and companies are facing. The buying commitments are segregated by industry sector and include purchase obligations, such as \$120b in US manufactured

goods, including machinery and electrical equipment; \$80b in US agricultural products; and \$30.1b in energy products, including LNG and crude oil. All aforementioned commitments are to be met within 2020, with additional increases in purchases extending into 2021.

When the question around China fulfilling its purchasing obligations has been raised to President Trump, he has stated, " ... if they don't buy, we'll terminate the deal."⁷ Termination of the Phase One deal is provided for in Article 8.3 of the Agreement, which states that either party may terminate the Agreement by providing written notice.⁸ The termination would then go into effect 60 days after written notice was provided, or another date as decided upon by the parties.

Mainland China's recent actions towards the semi-autonomous region of Hong Kong have further increased tensions between the US and mainland China. Speaking on the matter in late May, President Trump stated that he has directed his Administration to begin the process of eliminating policy exemptions provided to Hong Kong.¹⁰ One such exemption is goods with a country of origin Hong Kong are not included under the Section 301 punitive tariffs imposed on mainland China. As the process is still ongoing, there have been no direct trade impacts formally announced to date, however, disruption to business regarding trade are to be expected.

⁷ See White House remarks, "Remarks by President Trump in a Fox News Virtual Town Hall."

⁸ See Footnote 1.

⁹ *Id*

¹⁰ See White House remarks, "Remarks by President Trump on Actions Against China".

US companies conducting trade with Hong Kong and mainland China should closely monitor the evolving situation.

The continuation of punitive tariffs without a clear end in sight, coupled with the global financial strains due to COVID-19, have companies looking to free up cash now more than ever.

In the short-term, companies are concerned about liquidity in the current economic climate with COVID-19. While the US enacted a duty deferral option for companies facing financial hardships due to COVID-19, trade remedies such as Section 301 were notably excluded from the action, meaning companies are still required to pay the punitive tariffs timely.

The long-term considerations for companies paint a similar picture. Ongoing tariffs, now coupled with the supply chain disruption caused by COVID-19, has companies taking a closer look at the option of diversifying supply chains, whether it be in the context of manufacturing operations or sourcing of raw materials. Moving operations or sourcing has many complexities and considerations outside of costs and capital. In addition to business operation considerations, companies are well advised to assess whether the proposed adjustment of supply chains will meet the US customs rules to confer non-Chinese origin for the purposes of optimizing duty position for Section 301 duty purposes.

In sum, companies are encouraged to continue to look at strategies to mitigate tariffs as they navigate the uncertain global economic climate. ■



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USMCA: The United States, Mexico and Canada prepare for a 1 July entry into force of the USMCA – impact on the trade in goods

The renegotiation of the North American Free Trade Agreement (NAFTA), a priority of the Trump Administration, will be complete with the successor agreement, the US-Mexico-Canada-Agreement (USMCA) taking effect on 1 July 2020. USMCA was negotiated in 7 rounds over a period of 13 months and will replace the NAFTA, which has been in force since 1994.

Current status

The US, Mexico and Canada have all issued their notifications of the USMCA, which formalized the entry into force of the Agreement on 1 July. While Mexico and subsequently Canada completed notification procedures in time to meet a 1 June implementation, the US was unable to complete the notification within the required framework, despite

signaling initial interest in meeting the 1 June date. The US has cited responsiveness to the economic difficulties from the developing COVID-19 pandemic as a primary reason for the delay.

The Uniform Regulations that provide interpretation, application and administration of Chapter 4 (Rules of Origin), Chapter 5 (Origin Procedures), Chapter 6 (Textile and Apparel Goods) and Chapter 7 (Customs Administration and Trade Facilitation) of the USMCA were agreed by the three countries on 3 June.¹ These regulations will assist the trade community in preparing for the considerable changes from the current NAFTA regulations to those anticipated in the USMCA. In addition to the Uniform Regulations, interim implementation regulations and alternative staging options have also been issued to allow for a gradual transition from NAFTA to the USMCA.

USMCA's key provisions and interim measures taken by the US, Mexico and Canada

The USMCA maintains NAFTA's virtually tariff-free market access for each party's exports, reinforces each country's relative position as a competent investment destination for production and provides new market access opportunities while also maintaining their supply management system.²

¹ The Uniform Regulations provide in detail the guidelines each country will need to follow in order to interpret, apply and implement the USMCA domestically. The Regulations are subject to legal review in English, Spanish and French for accuracy, clarity and consistency. The United States has posted them here: <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/uniform-regulations>. Mexico has posted them here: <https://www.gob.mx/t-mec/acciones-y-programas/textos-finales-de-las-reglamentaciones-uniformes?state=published>. Canada's posting is pending.

² *The Canada United-States-Mexico Agreement: Economic Impact Assessment*. Global Affairs Canada. <https://www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusma-aceum/CUSMA-impact-repercussion-en.pdf>.



More specifically, the USMCA maintains key obligations governing trade in goods within North America, including:

- ▶ Provisions on national treatment
- ▶ Temporary admission of goods
- ▶ Import and export restrictions
- ▶ Administrative fees and formalities
- ▶ Goods returned after repair or alteration

In addition, USMCA contains enhanced transparency provisions for import and export licensing procedures that will provide greater certainty and predictability, and new rules to address non-tariff barriers related to trade in remanufactured goods.

While all the above items equally benefit the three USMCA parties, each country is separately preparing (and in some cases jointly) for its implementation as described below.

US

The US released the USMCA Interim Implementation Instructions.³ The interim instructions clarify how some of these changes will be enacted in conjunction with the Uniform Regulations.

The instructions provide general guidance, as well as specifics for textile goods⁴ and automotive products⁵.

Notable general instructions include the following:

- ▶ In a change from NAFTA, while the USMCA does not utilize a standard certificate of origin (COO), the instructions provide the minimum required data elements. In the same vein,

importers are now able to produce their own COO. Not surprisingly, importers are still expected to maintain proper documentation when claiming eligibility.

- ▶ The merchandise processing fee (MPF) will continue to be waived when claiming preferential treatment at import; however, the MPF will not be refunded in post-importation claims, such as when the product was not declared as originating at the time of import.
- ▶ Except for certain agricultural goods, the marking rules are separate from qualification rules. In other words, it is not a prerequisite that a product is marked as a product of Canada or Mexico to receive preferential tariff treatment under the USMCA.

Canada

Similar to the US, on 3 April, Canada Border Services Agency (CBSA) released a Customs Notice providing information on upcoming changes to the Customs Tariff due to the implementation of USMCA and the requirements to benefit from USMCA preferential tariff treatment once the agreement enters into force.⁶

In summary, the Customs Notice specifies the following:

- ▶ **Tariff provisions:** two tariff treatment codes will be available for entitlement to USMCA preferential tariff treatment in Canada – United States Tariff (UST, tariff treatment code 10) and Mexico Tariff (MXT – tariff treatment code 11)
- ▶ **Advanced rulings:** any advanced rulings for origin issued under NAFTA will not be valid for goods imported under USMCA preferential tariff treatment.
- ▶ **Proof of origin:** USMCA proof of origin will consist of a set of minimum data elements contained in Annex 5-A of Chapter 5 of USMCA, that may be placed on an invoice or any other document. Paragraph 11 of the Customs Notice lists all the required minimum data elements that must be included for certification of origin.
- ▶ **Transshipment:** transshipment is permitted, provided the transshipment conditions in Article 4.18 of Chapter 4 of USMCA are met and the documentation requirements are contained in Article 5.4(3) of Chapter 5 of USMCA.

³ [USMCA Interim Implementation Instructions](#) published by US Customs and Border Protection (CBP) on 20 April 2020.

⁴ For example, a yarn forward approach requires the yarn and intermediate fabric to originate in a party country and final cutting and sewing of the garment to occur within a party country; textile and other sets only qualify for the USMCA if every component in the set is originating, or if the entire set does not exceed 10% foreign value content (i.e., the entire set meets de minimis); and specific rules are laid out for short supply goods, where textiles could still originate under the USMCA if the underlying yarn and fabrics cannot be timely sourced in the Agreement's territory.

⁵ For example, the interim instructions provide fixed hourly rates averages for the Labor Value Content (LVC) calculation that would constitute high wage work and confirm such rates will not be tied to an exchange rate, and currently have no described method on how to account for inflation; regarding the USMCA's requirement that 70% of the purchases of steel and aluminum must be originating in a party country, the instructions include a list of Harmonized Schedule (HS) codes to specify which products are subject to this requirement, which include the steel and aluminum for major stampings that form the chassis; and related to automotive the instructions also list subheading HS codes of the core parts subject to increased standards.

⁶ Customs Notice 20-14, Implementation of the Canada-United States-Mexico Agreement (USMCA). <https://www.cbsa-asfc.gc.ca/publications/cn-ad/cn20-14-eng.html>.



- ▶ **Refunds:** an application for a refund under paragraph 74(1) (c.11) of the Customs Act may be made within four years from the date the goods were accounted for under subsections 32(1), (3) or (5), in respect of goods that were imported from the United States or Mexico on or after the date of entry into force of USMCA.

Regulatory amendments and new regulations made under the Customs Act as a result of the implementation of USMCA are expected to be announced in a separate Customs Notice.

Mexico

Mexico has not issued Interim Implementation Instructions. Implementation of the USMCA in Mexico is further complicated by new commitments on the functioning of the Labor market and environmental standards. Changes to the labor

and environmental requirements, in particular, are expected to impact company operations, as so far there is not detailed guidance.

- ▶ **Labor:** provisions aimed at promoting the international recognized labor rights and guaranteeing protection for migrant workers require a call for a verification mechanism to operate through a panel of independent experts chosen by the parties. The panel will have the power to request on-site verification visits to check possible labor violations that, if confirmed, the complaining party will have the power to impose any of the following sanctions:
 - ▶ Suspension of preferential tariff treatment for the export of goods
 - ▶ Imposition of fines on exported products or services
 - ▶ Denial of the export of goods in case of recidivism (repetition)
- ▶ **Environmental:** the various international environmental commitments that Mexico has made via conventions and treaties are included in the text of the USMCA. To back up such commitments, the following provisions were added to the USMCA:
 - ▶ A dispute resolution committee, similar to the one for labor, was established to provide for a viable and clear road related to solving environmental disputes
 - ▶ Serious crime or felony conviction is defined as conduct that constitutes a crime punishable by a maximum deprivation of liberty of at least four years or a more severe penalty

- ▶ Intentional transnational trafficking of protected wildlife will be treated as a serious crime, in addition to regulating issues such as illegal fishing

Joint implementation efforts

For the automotive industry, the US, Mexico and Canada agreed to the issuance of consistent and homogeneous implementation rules to apply for an alternative staging regime.

The rollout of the USMCA rules of origin for passenger vehicles and light trucks was designed for a three-year implementation period. However, due to the complexity of the automotive rules of origin,⁷ the USMCA contains the possibility of applying an “alternative staging regime,” which would give those vehicle producers that are approved for such regime a total of five years to implement the new automotive requirements, and the vehicles will have different RVC and LVC thresholds. This alternative staging regime does not replace or change any other rules of origin or conditions of applicability for preferential treatment under the USMCA.

Accordingly, all three countries recently issued USMCA Autos Alternative Staging Regime.⁸ In this regard, Article 8 of the Appendix to Chapter 4 (Rules of Origin) of the USMCA provides for the alternative

⁷ Automotive changes include labor provisions, where automakers must verify 40% to 45% of auto content was made by workers earning at least \$16 an hour, the introduction of core part components, and an increase in required North America content from 62.5% to 75%.

⁸ On 21 April 2020, the Office of the United States Trade Representative (USTR) published the Procedures for the Submission of Petitions by North American Producers of Passenger Vehicles or Light Trucks to Use the Alternative Staging Regime for the USMCA Rules of Origin for Automotive Goods; Mexico published its respective procedures on 30 April 2020 in the official gazette (Diario Oficial de la Federación); and Canada on 24 April 2020 (Global Affairs Canada).

staging regime, during which eligible passenger vehicles and light trucks would be subject to a longer period of transition for a specified period (“transition period”). Producers of heavy trucks may also request participation for the alternative staging regime, and if granted they will have a total of seven years for implementation of the new requirements.

To be eligible for an alternative staging regime, vehicle producers must submit a request to each of the USMCA party’s import authority. If the request covers more than 10% of the producer’s total North American production, the Agreement requires that a “detailed and credible plan” be submitted. The plan should describe the changes the producer intends to make to its operations, sourcing and vehicle content to meet the USMCA rules of origin at the end of the transition period. All three USMCA parties must agree to the granting of an alternative staging regime to a vehicle producer. For a producer to be considered for this benefit, the producer must submit a petition with a draft proposal of their alternative plan by 1 July 2020, and the final petition must be submitted by 31 August 2020.⁹

Actions for businesses

Businesses should prepare for the USMCA’s 1 July entry into force by modeling the impact of any changes to their operations and setting plans to implement any procedural changes that may be required. Particularly, the announced changes to rules of origin will make qualifying for existing benefits more difficult. In addition, companies should consider whether they can enjoy any new benefits under the USMCA.

A comprehensive understanding of current benefits under the NAFTA are essential for companies to appreciate what could be at risk under the new Agreement. Data obtained from the customs authorities can be used to determine where there is risk for any impact. Companies should evaluate whether any changes may be required, such as to sourcing or supply chains, to satisfy new requirements and to preserve the originating status of goods under the terms of the USMCA.

Immediate actions for companies to take include:

- ▶ Assemble relevant trade data from Canada, Mexico and the US
- ▶ Read the Interim Implementation Instructions in detail and begin to analyze:
 - ▶ Applicable rules of origin, how the existing rule is currently met and how it will change under the USMCA
 - ▶ Preliminary LVC and steel and aluminum content procedures (automotive, if applicable) according to the Interim Instructions
 - ▶ New origin certification and recordkeeping requirements to ensure future compliance with USMCA obligations and preparation to communicate these to other parties in the trade equation (i.e., customers, suppliers, etc.)
- ▶ Review the recently posted Uniform Regulations, that contain more detail and cover a broader set of topics than the interim guidance. Companies may need to adjust processes based on the Uniform Regulation detail.

- ▶ North American producers of passenger vehicles and light trucks should evaluate their ability to meet the new rules of origin (ROOs) by the expected 1 July entry into force and may consider applying for the Alternative Staging Regime for compliance with the USMCA’s rules of origin.
- ▶ Be prepared for increased enforcement such as free trade agreement audits by local customs authorities. ■

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⁹ In the US, requirements for the proposal may be found in the corresponding Federal Register notice [2020-08405](#). The USTR will make its decision based on the information contained in the submission and will consult with the Interagency Committee on Trade in Automotive Goods as needed. USTR will notify applicants within 30 days of submission of their draft plans of any deficiencies in their submission, and the amended submission must be resubmitted by 31 August.

US: Court clarifies treatment of related party trademark royalties and payments for services

A difficult issue for importers worldwide is determining when royalties and other payments made by a buyer of imported merchandise to a party related to the seller must be added to the transaction value of the imported merchandise. The US Court of International Trade¹ has issued a decision on 17 December 2019, *Trimil S.A. v. United States*, Slip Op. 19-161 (2019), which adds substantial clarity for US importers.

Background

Trimil is the US importer of Giorgio Armani apparel, and is partially owned by Armani. Trimil purchased Armani-branded apparel from two related manufacturers, and entered into agreements with Armani for advertising assistance, and with an Armani subsidiary for trademark licenses for the Armani brands. Both the advertising fees and the royalties for the trademark license were calculated as a percentage of the net revenue of Trimil's US subsidiary on resale of the purchased products in the US, each with a guaranteed minimum amount.

Trimil declared the customs value on import into the US using transaction value, defined as the "price actually paid or payable for the merchandise when sold for exportation to the United States." When

using transaction value to determine customs value, there are five specified additions to that value when they are not already included in the invoiced price.² One of those additions is for:

"Any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly, as a condition of sale of the imported merchandise for exportation to the United States."³

US Customs determined that the advertising fee and royalty should be included as part of the dutiable value, either as part of the price paid or payable for the goods, or as an addition to value. After exhausting its administrative remedies, Trimil filed suit in the Court of International Trade.

Court's analysis

Advertising fees

The Court looked first at the advertising fees, paid by Trimil to have the products "adequately advertised" in the US, and for Armani agreeing with Trimil on themes for advertisements, designation media placements and public relations activities. Customs argued that the fee, calculated as a percentage of resales, was paid as part of an overall strategy



for the brand, connected with design and sale of the products. Additionally, Customs argued that payment of the advertising fee was necessary to keep all of the related party agreements in full force and effect – enabling the manufacturers to sell and Trimil to buy the Armani products. Because the statute defines "price actually paid or payable" as "the total payment ... made, or to be made, for the imported merchandise by the buyer to, or for the benefit of the seller,"⁴ Customs argued that this overall scheme indirectly benefited the sellers.

The Court disagreed with Customs, stating that Customs' regulation interpreting price paid or payable "makes clear that 'benefit' has a narrow meaning, especially as to 'indirect' payments." The

1 The US Court of International Trade is a federal trial court with exclusive jurisdiction over customs cases.

2 19 USC §1401a(b)(1). The provision is the same as that provided in WTO Valuation Agreement Article 1.

3 19 USC §1401a(b)(1)(D). The adjustments to transaction value are found in Article 8 of the WTO Valuation Agreement; the royalty provision is Article 8(c).

4 19 USC §1401a(b)(4)(A); the equivalent language is in the WTO Valuation Agreement Interpretive Note to Article 1

Court went on to say that any benefits that the manufacturers receive from Trimil's ability to place orders is "so tangential to the fees paid to Armani for advertising as to be unquantifiable (if it exists at all)." Dismissing the possibility that the advertising fees were part of the price paid or payable for the product, the Court went on to state that the advertising fees are not listed in any of the five specified additions to value, and therefore cannot be added under those provisions.

Royalty

The Court next addressed the trademark royalties, first dismissing that the royalties paid to a party related to the seller could be part of the price paid or payable for the same reasons that the advertising fees were not included.

The Court then cited Customs regulations that further clarify when royalties should be an addition to the price paid or payable:

Royalties or license fees for patents covering processes to manufacture the imported merchandise generally will be dutiable. Royalties or license fees paid to third parties for use, in the United States, of copyrights and trademarks related to the imported merchandise generally will be considered selling expenses of the buyer and not dutiable. The dutiable status of royalties or license fees paid by the buyer will be determined in each case and will depend on (1) whether the buyer was required to pay them as a condition of sale of the merchandise for exportation to the United States, and (2) to whom and under what circumstances they were paid. Payments made by the buyer to a third party for the right to

distribute or resell the imported merchandise will not be added to the price actually paid or payable for the imported merchandise if the payments are not a condition of the sale of the merchandise for exportation to the United States.⁵

The Court focused on the condition of sale language and concluded that the royalties in question did not have to be paid as a condition of sale:

"[Customs] has pointed to no part of any of the Trademark Agreements indicating that the payment of the trademark royalty fees was a condition for exportation of the clothing to the United States. Nor has it pointed to any other convincing evidence that production would be halted were the trademark royalty fees not paid does not transform them into conditions of sale for exportation."

Implications for importers

Importers that are part of a related group commonly purchase product from one group member and pay fees for services or intellectual property to other group members. The Court's guidance as to the narrow definition of "benefit" should allow importers greater certainty that payment for specifically defined items unrelated to the imported products should not be recast as part of the transaction value. Of course, it remains important to precisely define the services or intellectual property purchased by the importer, and to appropriately value the payments.

The guidance on royalties paid to a party related to the seller is particularly welcome. US Customs has historically, as it did in the *Trimil* argument, implied

a condition of sale from facts and circumstances. US Customs Headquarters rulings when royalties are paid to a party related to the seller are fact-specific. There are a number of rulings in which the condition of sale is implied by the facts, and others in which a condition of sale is not found. *Compare* HQ H236746 (1 July 2013), HQ 546072 (21 May 1998) and HQ 545035 (23 August 1995). The Court of International Trade decision requires clear evidence of the condition of sale, whether from the documents or from other evidence. Moreover, the possibility of a termination of future rights to purchase is not enough to make this implication. These two statements by the Court should help eliminate ambiguity that may exist solely because the parties are related and focus the inquiry on whether there is evidence of a condition of sale.

US Customs chose not to appeal the *Trimil* decision and to date has not issued any guidance that references the decision. We will provide updates on subsequent administrative guidance in future issues of *TradeWatch*. ■

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⁵ 19 CFR § 152.103(f).

US: Court of international trade invalidates US Customs regulation restricting excise tax drawback

The latest chapter in the ongoing saga of US Customs and Border Protection's (CBP) and the US Department of the Treasury's (collectively, the "Agencies") attempt to limit the ability of importers to recover excise taxes paid on import through substitution drawback has ended with a victory for importers. In *The National Association of Manufacturers v. United States*, Slip Op. 20-9 (CIT 2020), the Court of International Trade ruled that a regulation adopted by CBP that restricted excise tax recovery was contrary to the statutory language adopted by Congress, and thus invalid. The Agencies have appealed the case, so this chapter is not the last.

Background

Drawback is the ability to obtain a refund of customs duties, fees and taxes paid with respect to the importation of articles into the US when those articles, or like-kind articles, are exported or destroyed.¹ When a like-kind article is exported, drawback is referred to as "substitution drawback," in that the export of the like-kind article allows the refund of duties, fees and taxes paid on the imported article.

The rules on "like-kind" were changed in 2016 to allow an export with the same eight-digit Harmonized Tariff System (HTS) classification to be substituted for an import.² The previous standard, with two limited exceptions, was based

on "commercial interchangeability," which meant that a branded product import required the export of the same brand and "SKU" (stock keeping unit, or identified product number). With the change in the substitution standard, drawback opportunities were significantly expanded. For example, cars are classified based on engine size, so a six-cylinder import of one brand and model can now be matched with a six-cylinder export of a different brand and model. Consumer items subject to excise tax also benefit; any import of beer can be matched with an export of beer, and any import of gin can be matched with an export of gin.



¹ The Customs drawback rules are codified at 19 USC § 1313.

² Amendments were made by Trade Facilitation and Trade Enforcement Act of 2015.

The two limited exceptions to the previous like-kind rule applied to two categories of products subject to excise taxes, petroleum and wine. Petroleum product drawback using eight-digit HTS substitution has been in place for many years, and exports of petroleum products have routinely allowed for the recovery of oil spill excise tax paid on imports. Wine substitution has been allowed if the color of the wine is the same (red or white) and the value of the export is within 50% of the value of the import. Wine exporters have also been receiving drawback on excise taxes paid on imports.

Without recounting all the previous chapters in this saga, the Agencies' 2009 proposal to restrict drawback of excise taxes merits specific mention. Both Agencies proposed regulations to restrict the drawback of excise taxes in October 2009.³ Following a substantial number of comments opposing the proposed regulation, including 28 from Members of Congress, the proposals were withdrawn in early 2010.⁴ Excise tax drawback for petroleum and wine companies continued without issue.

In 2018, CBP proposed a comprehensive set of new drawback regulations and included a restriction on excise tax recovery that was substantially the same as the restrictions proposed in 2009 and withdrawn in 2010.⁵ There were again a significant number of comments opposing the proposed excise tax



restriction, but this time CBP adopted the regulation with two notable changes to the final rule:

- ▶ First, CBP removed oil spill excise tax from the list of excise taxes with restricted recovery.
- ▶ Second, CBP changed the definition of “drawback,” and “claim for drawback” from the long-standing regulatory definitions to make them compatible with the excise tax restriction.

The Agencies' objection to substitution drawback of excise taxes is policy driven. Excise taxes are generally imposed both on imported products and on domestically made products that are consumed domestically. Excise taxes do not apply to exports. So, for example, red wine produced in the US can be exported without incurring excise tax. Absent the

regulatory restriction sought by CBP, the exporter could use that exported wine as a substitute for imported wine and claim a refund of 99% of the excise taxes paid on the import (along with the duties and fees paid). CBP's regulation allowed excise tax recovery only to the extent excise tax was paid on the export, a situation that rarely, if ever, happens. With the relaxation of the like-kind standard enabling more substitution of alcohol and tobacco products subject to excise tax, the 2009 proposal that had been withdrawn was brought back and adopted.

Following adoption of the final regulation, the National Association of Manufacturers filed suit challenging the regulations restricting excise tax recovery and the expanded definitions to support the restriction as violative of the governing statute.

³ Drawback of Internal Revenue Excise Tax, 74 Fed. Reg. 52928 (proposed Oct. 15, 2009), and Drawback of Internal Revenue Taxes, 74 Fed. Reg. 52937-01 (proposed Oct. 15, 2009).

⁴ Drawback of Internal Revenue Excise Taxes, 75 Fed. R. 9359-02 (withdrew March 2, 2010).

⁵ The Notice of Propose Rulemaking was published in Federal Register, Vol. 83, No. 149, August 2, 2018.



Standard of review

A final agency regulation is set aside if a court finds the regulation to be “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A); *Motor Vehicle Manufacturers Association of U.S., Inc. v. State Farm Mutual Auto Insurance Co.*, 463 U.S. 29, 42 (1983). The Court first looks to determine whether the final regulation conflicts with the statute by applying a two-step framework established by the Supreme Court in *Chevron USA Inc., v. Nat’l Res Def Council, Inc.*, 467 US 837 (1984). The Court first ascertains whether Congress has “directly spoken to the precise issue at issue.” If Congressional intent is clear, the inquiry ends, and the regulation is invalidated. If the Court determines that the statute is silent or ambiguous, the Court then determines whether the regulation is a permissible interpretation of the statute, or instead is arbitrary or capricious.

Court’s analysis

The Court determined that the inquiry ended with step one; the regulation conflicts with the unambiguous text of the statute.

The Court first looked at the regulation’s newly expanded definition of drawback, stating that to prevail CBP “must succeed. in the redefinition of drawback.” The final regulation added to the end of the longstanding definition of drawback one additional phrase: “More broadly, drawback also includes the refund or remission of other excise taxes pursuant to other provisions of law.” The Agencies claimed that this amendment to the definition of drawback is merely a clarification of the commonly understood meaning of the term:

“drawback,” according to the Agencies, is intended to include refunds under the customs regime, as well as any tax liability that is extinguished pursuant to another provision of law. With that definition, the Agencies state that an export of a tax-exempt product has already been subject to “drawback,” and consequently cannot be used to claim drawback a second time. The Agencies termed the many years of previous refunds of wine excise taxes “a mistake.”

The statute does not contain a definition of “drawback,” so the Court first looks to the ordinary meaning of the term and cites a number of dictionary definitions that refer to drawback as a refund or cancellation on duties or taxes incurred on import when an export occurs. The Court then goes on to examine the use of the term “drawback” by Congress, concluding that the statute almost exclusively uses drawback to refer to duties, taxes and fees incurred on import that are refunded. The Court also states that the construction offered by CBP “makes no logical sense,” as excise taxes are almost never paid on export: “A tax that has never been paid cannot naturally be said to have been ‘draw back.’” Thus, the Agencies’ expanded definition is neither the ordinary meaning of the term “drawback,” nor does it comport with the context of the terms as used by Congress.

The Court could have ended its analysis at this point but goes on to point out a number of statutory conflicts that would arise if the Agencies’ definition was correct. First, the Court states that there is nothing in the statute to suggest that drawback is conditioned on the tax status of the exported product. In fact, the statute states that

“notwithstanding any other provision of law,” refunds of duties, taxes and fees paid on import are to occur on exportation of a substituted product. The Agencies’ interpretation would “render the word ‘notwithstanding’ meaningless.” Moreover, the Agencies’ interpretation conflicts with the statutory direction on calculating the drawback to be paid and would lead to what the National Association of Manufacturers characterized as “absurd results” in attempting to follow the statutory language.

Finally, the Court addresses the Agencies’ policy argument, which the Agencies claimed is required to “vindicat[e] the animating principle[s]” of both the federal excise and drawback regimes. The Court points out that the purpose of the excise tax regime is to raise revenue, while the drawback regime is meant to encourage exports by providing exporters a refund of taxes paid on import. The Court concludes:

Because these two regimes necessarily cannot operate with full force, a policy decision must be made regarding which to privilege when they collide. As the legislative history of the drawback regime demonstrates, it appears that Congress has repeatedly chosen to expand the access to drawback at the expense of lost excise tax revenue. The agencies cannot now attempt to alter this policy choice by way of a regulation that does not comport with the animating statute.

The Court states that a review of relevant legislative history is unnecessary because the “statutory text and structure forecloses” the Agencies’ interpretation. Nevertheless, the Court goes on to recite the legislative history of drawback as completely supportive of the Court’s decision.

Implications for importers

Because CBP has appealed the decision, this saga will continue for at least one more chapter. In the meantime, US importers and exporters of excisable product need to be cognizant of timeframes applicable to drawback claims. Drawback claims can be made up to five years after the import date, so claims can be made now for imports that occurred in mid-2015. Once that five-year period expires, a claim for refund on the import cannot be made. Importers with claims that may expire before a final decision is made by the Appellate Court should consider filing claims to preserve their rights.

Importers and exporters may also want to review supply chains to see if adjustments can be made to enable or optimize drawback. Several companies have already done this in anticipation of a favorable result from the Courts. Those that have not may be more comfortable doing so after reviewing the Court of International Trade’s decision.

In a broader sense, the case serves as a good reminder on the limits of regulatory actions. Congress makes policy decisions, and CBP cannot override those decisions by regulation. ■

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US: New country of origin reporting requirement on composite goods could have broad compliance and operational impacts



Customs and Border Protection (CBP) issued new, public instruction via a Cargo Systems Messaging Service (CSMS) regarding the appropriate reporting of country of origin of pipe spools with components from multiple countries of origin. The CSMS instructs importers of pipe spools to report separately as an entry line item each pipe spool component that has a differing country of origin. This differs from the standard practice where importers report a single country of origin and a single US Harmonized Tariff Code (HTSUS) for a single article of commerce.

As published, this guidance presents significant operational implications, as companies' ERP systems generally maintain one country of origin for one SKU. This guidance can also be material from a financial standpoint, as CBP is now able to apply punitive tariffs and trade remedy duties on such imports.

The instruction itself is currently limited to specific applications for the petrochemical and construction industries. CBP personnel have suggested to us that this concept could be applied more broadly, however, and if it is, importers will need to find ways to update their procedures and systems to meet the reporting requirements and may face additional duties.

Background

Pipe spools are custom pipe segments designed to fit into a specific location in an existing or proposed industrial facility, such as a chemical plant, oil refinery or power generation facility. Pipe spools are generally prefabricated components of a piping system consisting of various types of pipes, flanges, elbows and fittings, and may contain line pipes and other components, such as valves. They may also include insulation, painting or other forms of finishing.

On 24 March 2020, CBP issued CSMS # 42133823 providing public instruction on how to make entry on pipe spools manufactured from pipe and fittings of varying origin.¹ The new guidance only refers to pipe spools fabricated from components from multiple countries of origin and instructs importers to identify component materials subject to trade remedies or punitive tariffs on separate customs entry lines by origin.

Rationale for new requirement

CBP has determined that it is not uncommon for pipe spools to be manufactured with pipes and other components from multiple countries, where the component materials, if imported separately, would be subject to various trade remedies and punitive tariff measures, such as antidumping duties, 301 duties or 232 duties. These trade remedies and punitive tariffs are based, in part, on the classification and the country of origin of the imported product. Although the finished pipe spool is considered a single product with a single classification, the new guidance states that the pipe spools with components from multiple countries of origin will retain each of those countries of origin on import into the US.

Although the requirement was only recently published, its concept can be traced back to a 2016 Department of Commerce International Trade Administration (ITA) antidumping and countervailing duty scope ruling² in which the ITA found that the pipe spools were a set of related products rather than a composite good and, as such, the individual pipes and fittings of which they were constructed were each individually within the scope of several antidumping and countervailing duty orders covering pipe and fittings. Specifically, the ITA did not apply a substantial transformation³ analysis to the fabrication of the pipe spools. Instead, the ITA applied a mixed media analysis that looked at the parts individually rather than as part of a whole in reaching its determination that a pipe spool is a set of related products rather than a new and different article. In taking this approach, the ITA determined that if pipe spool components are subject to antidumping or countervailing orders, they remain so post-fabrication.

Although the scope ruling was applicable only to the referenced antidumping orders, CBP in conjunction with the Commercial Customs Operations Advisory Committee (COAC), a body of private sector individuals who advise on the commercial operations of CBP, developed a policy for the application of trade remedies and punitive tariffs to pipe spools that would be applied uniformly to all

importers. The guidance follows the ITC approach of “looking through” fabricated pipe spool systems to require a breakdown of the constituent components for origin purposes.

There have been other recent attempts to “look through” and assess trade remedies on foreign origin components imported as part of a finished product. For example, a recent AD/CVD investigation into fabricated structural steel attempted to include in its scope description various items incorporating fabricated structural steel such as modules, modularized construction units and subassemblies of fabricated structural steel, whether assembled or partially assembled.⁴ Although the International Trade Commission issued a final negative determination on the investigation, the proposal follows the same approach as is used in the CBP pipe spool guidance.

New reporting requirements

CBP is instructing that imported pipe spool manufactured with pipes and components from multiple countries be separately identified as multiple line items on the customs entry and be accompanied by a commercial invoice accounting for the portion of value and countries of origin for the pipes and components that make up the pipe spool. Duties, including corresponding punitive tariff or trade remedies duties are computed by line item. All other reporting requirements, including Section 232 or 301 exclusions (if applicable), should also be reported on the corresponding line. Lastly, in accordance with CBP ruling precedent addressing the classification of pipe spools pursuant to HTSUS General Rule of Interpretation 3(b) based on essential character, each line should use the same tariff classification, applying the classification of the primary pipe material to the assembled pipe spool.⁵

1 CSMS #42133823: https://content.govdelivery.com/bulletins/gd/USDHSCBP-282e93f?wgt_ref=USDHSCBP_WIDGET_2.

2 See Memorandum titled “Final Scope Ruling for Engineered and Manufactured Pipe Spools Imported from China as part of the current Scopes of the Orders on Carbon Steel Butt-Weld Pipe Fittings; Circular Welded Carbon-Quality Steel Pipe; Circular Welded Austenitic Stainless Steel Pressure Pipe; and Seamless Carbon and Alloy Steel Standard, Line, and Pressure Pipe from China,” dated August 15, 2016 (Westlake Ruling).

3 The fundamental test for determining a substantial transformation is whether the processing, which must be a manufacturing process, results in an article with a new name, character or use from that of the constituent materials.

4 <https://enforcement.trade.gov/download/factsheets/factsheet-multiple-fabricated-structural-steel-ad-prelim-090419.pdf>.

5 Pipe spools are commonly classified under Chapter 73 of the HTSUS according to the specifications of the pipe that imparts the essential character of the pipe spool. However, in certain instances where a pipe spool incorporates materials in addition to merely pipe and fittings, such as valves, the spools are classified based on the essential character imparted by the valves, typically classified under Heading 8481 of the HTSUS. CBP NY Ruling N262359 <https://rulings.cbp.gov/ruling/N262359>.

Implications for importers

Pipe spool importers should examine operational considerations of an ERP system, many of currently incorporate one-part number, or SKU, for a particular type and/or size of composite good. The new CBP reporting requirement will necessitate information that would not be kept in current systems. Moreover, cost breakdown will now determine the percentage of the pipe spool that is associated with a particular country of origin. This may require additional documentation and transparency between supply chain partners, as well as input from engineering procurement and construction contractors (EPCs) and sourcing teams to make sure that they are retaining all necessary documentation and data such as procurement and manufacturing records, for all pipe spool imports, as well as a method to house the information.

The big question is the potential scope of application of the concept. There are related questions, for example, whether commodities such as construction modules incorporating pipe spools, which are not specifically addressed in this limited instruction, could be covered. But, there are many situations in which a commodity is considered a single item of commerce with a single HTS classification that contains identifiable components with different origins. It is unclear at this point how far reaching the CBP guidance on pipe spools may extend, but we have already encountered CBP officials referencing the pipe spool guidance in conversations about significantly different commodities. If this concept is expanded, it will be a significant departure from current practice, requiring changes to systems and processes, and potentially causing the application of trade remedies and penalty duties where they have not existed to date. How far this concept can be expanded before directly conflicting with the substantial transformation concept for determining origin is also an open question. ■



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US: Sanctions agency highlights compliance essentials and high-risk industries with recent enforcement trends



Organizations and individuals subject to US jurisdiction (including foreign entities that conduct business with the US) should be aware of, and incorporate as applicable into their sanctions compliance programs, lessons learned from enforcement actions by the United States Department of the Treasury Office of Foreign Assets Control (OFAC) regarding what the agency considers as deficiencies in sanctions compliance essentials, as well as those industrial sectors prone to be high-risk for violations. OFAC encourages covered organizations to employ a risk-based approach to sanctions compliance that is appropriate to the organization's risk touchpoints. Since 2019, OFAC's published enforcement actions have included more detail than ever before on the shortcomings of the targeted entities' circumstances that lead to the violation. A review of such past enforcement matters and the remedial measures undertaken thereafter can benefit any organization with a similar risk-profile to those described – an exercise which the agency itself recommends.¹

Background

US economic and trade sanctions laws prohibit or greatly restrict individuals and organizations from engaging in broad categories of transactions with targeted countries, regions, organizations and individuals. OFAC currently administers and enforces approximately 32 sanctions programs pursuant to various legal authorities. Violations are subject to hefty civil monetary penalties levied by the agency, or criminal prosecution by the US Department of Justice.

OFAC makes all its civil enforcement actions publically available, and since 2018, also has started including two additional useful compliance-related data points.² First, OFAC now frequently highlights the lessons to be learned from a

¹ U.S. Dept. of the Treasury, A Framework for OFAC Compliance Commitments, 2 May 2019.

² U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties and Enforcement Information* (last accessed 26 April 2020), available at <https://www.treasury.gov/resource-center/sanctions/CivPen/Pages/civpen-index2.aspx>

respective enforcement action. Second, the agency also includes comprehensive details on the specific risk mitigation remedial measures undertaken by the company in response to the violations. This additional information provides valuable compliance-related examples to organizations with similar risk profiles for their use in reassessing and enhancing their respective sanctions compliance programs.³ Evaluating OFAC's enforcement trends since January 2019 is useful in such an exercise (although such trends may change in the future).

Since 2019, OFAC's enforcement actions indicate an increased appetite in targeting compliance failures involving foreign subsidiaries and affiliates (including in regard to mergers and acquisitions), sanctions screening software oversights, as well as individual industries such as international shipping/logistics and civil aviation. Some important examples of such enforcement trends are outlined below.

Enforcement trends

Foreign subsidiaries and affiliates

US parent companies and their foreign subsidiaries or affiliates have been held liable in numerous OFAC enforcement actions for violating certain sanctions programs, irrespective of their industrial sectors. Specifically, under OFAC's Iran and Cuba sanctions programs, entities owned or controlled by US individuals/entities are prohibited from engaging in a wide range of transactions with Iran and Cuba, to the same extent as US persons themselves.⁴ OFAC has also increasingly focused on transactions where the compliance functions were not adequately layered into the merger, acquisition or integration process. In all such cases, OFAC emphasized the relevance of: (1) performing heightened due diligence, particularly with regard to affiliates, subsidiaries or counterparties known to transact with OFAC-sanctioned targets, or that otherwise pose high risks due to their geographic location, customers and/or suppliers, or products and services they offer; and (2) implementing risk-based and proactive controls, such as regular audits, to ensure subsidiaries are complying with their obligations under OFAC's sanctions regulations, including after an M&A transaction is completed.⁵

In one such enforcement action OFAC highlighted the importance of appropriately responding to early potential warnings of non-acquiescent conduct by foreign persons subject to US jurisdiction. During acquisition negotiations of a German entity, the US acquiring parent warned the German target that it would be required to cease all existing/prior transactions with Cuba post-acquisition.⁶ Further, after the acquisition, the parent provided written guidelines for complying with US sanctions to the key management employees of its new subsidiary. The parent company later discovered the German entity had created a scheme to conceal their Cuba business from it, continuing to complete and collect on existing orders with Cuban nationals, in violation of OFAC's Cuba program. A full investigation indicated that on two occasions the subsidiary's employees had indeed alerted the parent company (through reports to a general manager) about some indications that Cuba sales were continuing.

Sanctions screening software

Several recent OFAC enforcement actions demonstrate the importance of conducting the appropriate due diligence on customers and other counterparties not only when initiating and renewing customer relationships, but throughout the life of the commercial relationships.⁷ One of the most critical factors common to these cases was the wholesale reliance by the companies on their automated screening solutions without assessing any gaps in the program. This includes taking steps necessary to ensure that automated sanctions compliance control measures cannot be overridden without appropriate review.⁸ The respective sanctions screening software used by the subjects of these enforcement actions failed to match the names of their customers or counterparties that actually

³ OFAC had approximately 26 civil enforcement actions in 2019, whereas the previous five years were significantly less in their respective totals: 7 in 2018; 16 in 2017; 9 in 2016; 15 in 2015; and 22 in 2014. See also U.S. Dept. of the Treasury, *A Framework for OFAC Compliance Commitments*, 2 May 2019.

⁴ See 31 C.F.R. §§ 515.329 and 560.215.

⁵ U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties Information Chart*, Detailed Penalties Information for 7 Feb. 2019, 14 Feb. 2019, 27 March 2019, 11 April 2019, 6 Aug. 2019, and 1 Oct. 2019.

⁶ U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties Information Chart*, Detailed Penalties Information for 14 Feb. 2019.

⁷ U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties Information Chart*, Detailed Penalties Information for 1 Oct. 2019 and 25 Nov. 2019.

⁸ See also OFAC *Finding of Violation for Violations of the Weapons of Mass Destruction Proliferators Sanctions Regulations*, 30 April 2020.



were identified on the OFAC's sanctions lists, especially the specially designated nationals and blocked persons (SDN) list. Gaps in the software included:

1. Screening only the abbreviation of the SDN's name
2. Failure to match upper case names in the system with lower case names on the SDN list
3. Failure to match the listed address in the SDN entry with the address collected from the customer

Accordingly, OFAC highlighted the benefits of comprehensive sanctions lists screening that makes use of all the information on the SDN list, including the importance of considering OFAC screening and compliance measures that exploit names, addresses and other identifying information on the SDN list.

Civil aviation

OFAC targeted several civil aviation companies for alleged violations of various sanctions programs.⁹ While the agency earlier issued an industry advisory tailored to its Iran program (23 July 2019),¹⁰ lessons learned from subsequent

agency enforcement actions is that participants in this industry should be aware that transactions involving any other jurisdiction subject to OFAC sanctions may also implicate similar deceptive practices to those detailed in its Iran-related notice. For example, in November 2019, a Florida-based aviation services firm was subject to allegations of violations of the now defunct Sudanese Sanctions Regulations (SSR).¹¹ The firm leased three aircraft engines to a U.A.E. company, which then subleased the engines to a Ukrainian airline that in turn installed the engines on an aircraft it wet leased to Sudan Airways, an entity that was identified on the SDN list during the course of such violations. Even though the aviation services firm's lease agreement with the U.A.E. company contained US and UN sanctions terms prohibiting transfer of the engines to countries such as Sudan, OFAC determined this was not enough. The firm failed to ensure the engines were utilized in a manner that complied with its regulations, and it did not obtain US law export compliance certificates from lessees and sublessees. OFAC emphasized the importance of companies that operate internationally to implement screening and compliance measures that extend beyond the point-of-sale, and function throughout the entire business or lease period, which the firm sought to do as part of its remedial measures.

International shipping and logistics

In several enforcement actions targeting the international shipping and logistics sector,¹² OFAC determined that these companies failed to heed, and respond accordingly to, sanctions-related warning signs existing prior to the alleged violative conduct, including: (1) management's failure to properly account for underlying payment transfers from a sanctioned party that were known to have been blocked or rejected for compliance reasons by the remitting financial institutions and, (2) a company failing to notice information that the

⁹ See U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties Information Chart*, Detailed Penalties Information for 7 Nov. 2019 and 26 Feb. 2020. See also OFAC Finding of Violation for Violations of the Global Terrorism Sanctions Regulations, Dec. 12, 2019

¹⁰ U.S. Dept. of the Treasury, *Deceptive Practices by Iran with respect to the Civil Aviation Industry*, 23 July 2019

¹¹ U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, *Civil Penalties Information Chart*, Detailed Penalties Information for 7 Nov. 2019.

¹² The agency had also issued several advisories to the shipping community for sanctions related risks involving Iran, Syria, and North Korea. See also U.S. Dept. of the Treasury, *Updated Guidance on Addressing North Korea's Illicit Shipping Practices*, 21 March 2019; U.S. Dept. of the Treasury, *Sanctions Risks Related to Petroleum Shipments Involving Iran and Syria*, 25 March 2019; U.S. Dept. of the Treasury, *Sanctions Risks Related to Shipping Petroleum and Petroleum Products from Iran*, 4 Sept. 2019.

subject goods originated from, were loaded/unloaded at ports located in, or were transshipped through, countries or regions subject to comprehensive US sanctions.¹³

In the case of a New York-based international shipping group, the company's foreign subsidiaries had chartered Iranian vessels identified on the SDN list, for the transportation of goods between foreign ports.¹⁴ The vessel names and their IMO numbers – which were in the possession of the company's management – were both identified on the SDN list at the time the company had processed the electronic funds transfers, and managerial personnel were aware and had discussed sanctions compliance-related payment issues with involved financial institutions. Therefore, according to OFAC the company's culture of compliance appeared deficient at the time of the alleged violations of its Iran sanctions program. As a consequence, one of the company's remedial measures was to appoint an OFAC compliance officer. OFAC stressed that companies engaging in international transactions can realize the benefits of developing and maintaining a culture of compliance where senior management sets a positive example of compliance and encourages staff to comply with the law.

Key considerations for OFAC compliance

Whether a company is establishing a new sanctions compliance program or reassessing its current one to identify areas of enhancement, a review of OFAC's past civil enforcement actions, especially those actions that targeted organizations with similar sanctions risk profiles, is vital to avoiding missteps. In reviewing relevant enforcement actions since 2019, there is valuable compliance-related information that should be considered in view of the agency's enforcement trends targeting certain sectors, compliance vulnerabilities involving foreign subsidiaries and affiliates (including M&A's), and sanctions screening software oversights. Questions for consideration include:

1. If your company engages in M&A transactions, has foreign subsidiaries and affiliates, or is embarking on such activity, have you performed a risk profile to ensure controls are properly designed and implemented to address those risks?

¹³ See U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, Civil Penalties Information Chart, Detailed Penalties Information for 21 Feb. 2019, 2 May 2019, and 27 Jan. 2020.

¹⁴ U.S. Dept. of the Treasury's Resource Center's Financial Sanctions, Civil Penalties Information Chart, Detailed Penalties Information for 21 Feb. 2019, 2 May 2019.

2. If you are currently involved in any M&A transactions, are sanctions controls appropriately covered in due diligence?
3. How have you tested risk-based compliance measures in place to demonstrate they are effective and thorough? How do they extend beyond the point-of-sale? Are they capable of identifying and responding accordingly to sanctions-related warning signs?

In evaluating the effectiveness of your screening tools think about whether you have:

1. Tested your automated tool to see if and when it catches updates by name or by address?
2. Assessed the timeliness and methods by which your global trade management provider is uploading new content?
3. Conducted some periodic checks of the screening tool results against the consolidated screening lists (CSL) tool by randomly selecting various restricted parties from different lists to see what results? ■

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US: Texas Supreme Court defers to US Customs determination of “activation” in foreign trade zone property tax dispute

A significant benefit to many foreign trade zone (FTZ) users in Texas is an exemption from local property tax on inventory. A recent Texas Supreme Court decision clarifies the criteria for the tax exemption, overturning a troubling decision of the Court of Appeals for the First District of Texas.¹

An FTZ is an area physically located within the United States, where goods admitted into the FTZ are not subject to tariffs or duties until they leave the FTZ. One of the benefits available to FTZ users is an exemption from state or local property taxes imposed on FTZ inventory, which is particularly valuable in Texas which otherwise has a comparatively high tax rate on inventory.² Importantly, for a company to obtain this benefit, it must both be located in an approved FTZ location, and that location and specific operating entity must be “activated” for use by US Customs and Border Protection (CBP).³

Subsequent to activation, the FTZ operator is responsible for maintaining zone operations in compliance with the FTZ rules and regulations. One of the requirements states that if an existing FTZ operator undergoes a restructuring, which results in a new corporate entity, that new entity must apply for approval of a new activation.⁴

Case background

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

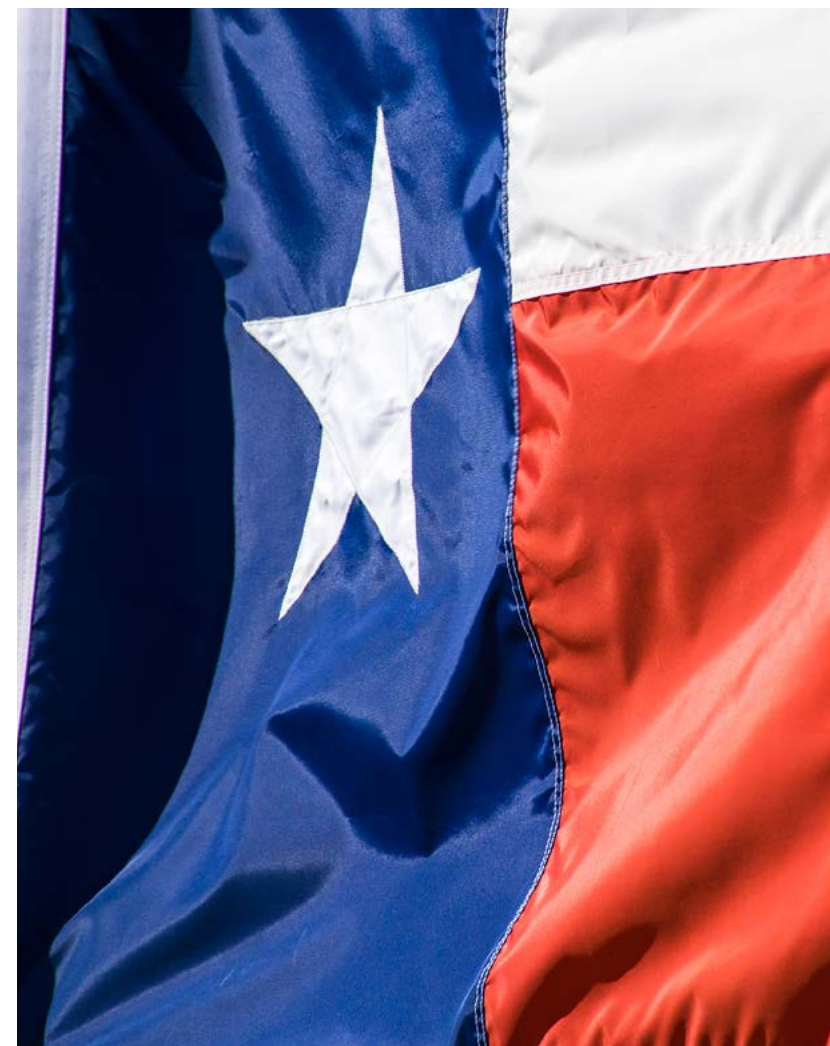
Additional entity restructuring changes in 2006 caused the FTZ operating entity to change once again, ultimately resulting in Pasadena Refining System, Inc., a Connecticut corporation (PRSI(CT)),

¹ PRSI Trading, LLC v. Harris County, No. 18-0664 (Tex. S.Ct. Feb. 28, 2020).

² The Foreign-Trade Zones Act provides that tangible personal property imported and held in an FTZ and domestic tangible personal property held in an FTZ for exportation is exempt from state and local ad valorem taxation. 19 USC § 810(e).

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

⁴ 19 CFR 146.1(b) and CBP Foreign Trade Zones Manual Section 4.14(a).

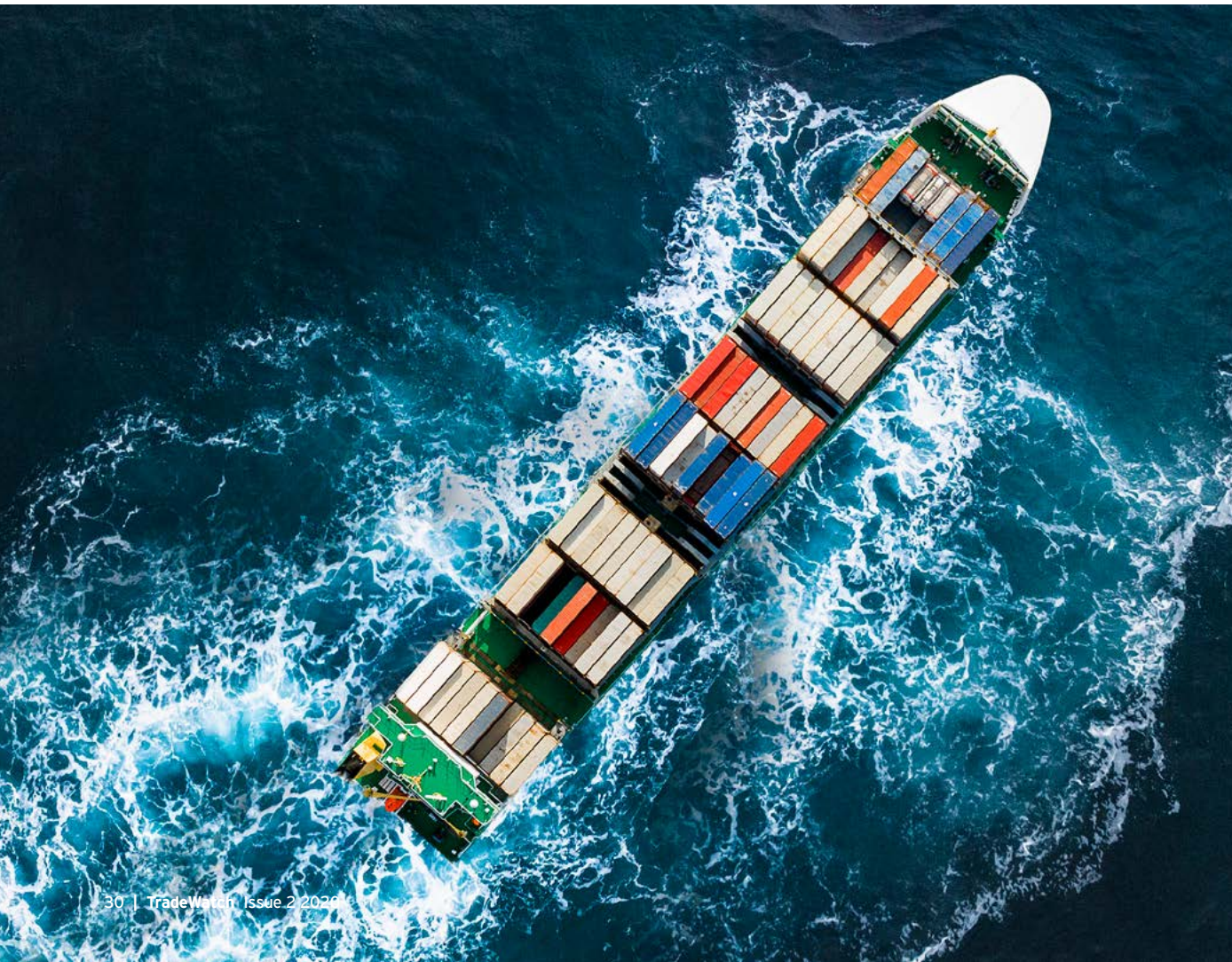


as the entity conducting FTZ operations. The new entity, PRSI(CT), requested approval from CBP as the new operator, but CBP did not grant the approval because the Port of Houston Authority had not provided the requisite grantee concurrence letter. Consistent with a policy it adopted in July 2006,

the Port of Houston Authority did not provide its concurrence letter for the operator change because PRSI(CT) had not obtained a letter of non-objection from Harris County (the county within which Houston is located).

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

Harris County petitioned the Harris County Appraisal Review Board for a determination that PRSI(CT) owed taxes during the tax period under review (2011 through 2013) because PRSI(CT) was not an approved operator during that period, and consequently the FTZ should not be considered activated. The Appraisal district denied relief. Harris County filed suit, and the District Court upheld PRSI(CT)'s entitlement to the tax exemption. That decision was reversed on appeal, the Court of Appeals ruling that the subzone could not have been activated during those years because CBP consistently declined to affirmatively approve the new zone operator absent the requisite grantee concurrence letter, and thus, PRSI(CT) could not have been authorized to receive FTZ tax exemptions.



PRSI(CT) appealed that decision to the Texas Supreme Court.

Was the FTZ activated?

The Texas Supreme Court determined that the key issue in the case was whether the subzone was activated during the tax years at issue. If it was, then the Court would determine that the ad valorem tax exemption applied to Pasadena's inventory.

Harris County argued that PRSI (CT) had not been an authorized operator of Subzone 84N since 2008 because CBP never approved PRSI(CT) as a new operator. Harris County maintained that since PRSI(CT) never obtained approval from CBP as a new operator, it could not have obtained the authority to operate the subzone in activated status and, therefore, was not entitled to the FTZ ad valorem exemption. Harris County further argued that the FTZ regulations allows for involuntary discontinuance of an activated status, which Harris County alleges occurred in this case.

PRSI(CT) argued that CBP's month-to-month letter approvals and continuous approval of zone admissions, as well as the issuance of annual activity permits during the time in question, constituted the necessary approval by CBP to continue operations of the subzone. Therefore, PRSI(CT) was eligible to obtain the tax exemptions.

Rendering judgment in favor of PRSI(CT), the Texas Supreme Court ruled that the subzone was activated during the tax years under review because the

subzone was not formally and voluntarily deactivated by CBP pursuant to CBP regulations. The court noted that under the regulations, deactivation must be requested by the grantee or the operator and then CBP will approve the deactivation after certain requirements are fulfilled.

The Texas Supreme Court noted that during the tax years in question, CBP continued to approve the admission of merchandise into the zone, and that fact in combination with the monthly extensions demonstrated that the zone was still activated and CBP never "implicitly deactivated" the zone.

The Texas Supreme Court further stated that Harris County's focus on the letter rulings ignored the "bigger picture." CBP allowed PRSI(CT) to continue operating the zone during the period under review until a determination was made by CBP to deactivate after the application by the grantee.

The Court rejected Harris County's theory of implied involuntary deactivation. It noted that CBP can discontinue the activation of a zone without grantee or operator involvement using the suspension procedures in the FTZ regulations, but CBP never used those procedures. Consequently, PRSI(CT) was eligible for the property tax exemption until the FTZ was formally deactivated by CBP in 2013.

Broader implications

The Texas Supreme Court decision overturns a very troubling Court of Appeals decision that, if followed to its logical conclusion, would have made operations

in a FTZ subject to uncertainty. The Court of Appeals decision is reached only by the Court of Appeals substituting its judgment for that of CBP, finding the FTZ deactivated despite no decision by CBP to do so. If a court can find that a CBP activation determination is ineffective, FTZ users could not be certain of obtaining any FTZ benefits conditioned on activation based on a CBP determination. The Texas Supreme Court decision defers to the agency responsible for activation and deactivation decisions, which provides certainty for FTZ users.

The case is also a good reminder that proper activation with CBP is a prerequisite to the FTZ property tax exemption. The case also highlights the importance of dealing promptly with any corporate reorganizations of an FTZ operator, as specifics of the corporate transaction can require new activation. It should be noted that such a lengthy process by CBP to deactivate the zone will likely not occur in other situations, and a business ignoring the reorganization requirements may face CBP suspending zone operations or initiating deactivation. ■

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China: Draft Export Control Law and implications for business

On 28 December 2019, the Export Control Law of China (Draft) (hereinafter referred to as “2019 Draft”) was deliberated at the 15th Session of the Standing Committee of the 13th National People’s Congress (hereinafter referred to as NPC). The Draft is an update from the version in 2017. As part of Industry Consultation, the NPC released the draft on its official website in the afternoon of the same day, seeking comments from the public. Export control laws can have a considerable impact to companies and demands appropriate focus and awareness.

Background

China’s current export control legal framework is composed of the prohibitions or restrictions on exports as part of the foreign trade law, the customs law, the criminal law and also separate administrative regulations that cover the control in specific areas, such as nuclear products, biological products, chemical products, missiles and military products. However, until now, China still does not have a comprehensive law specifically legislated to unify the country’s export control by consolidating these separate laws and regulations.

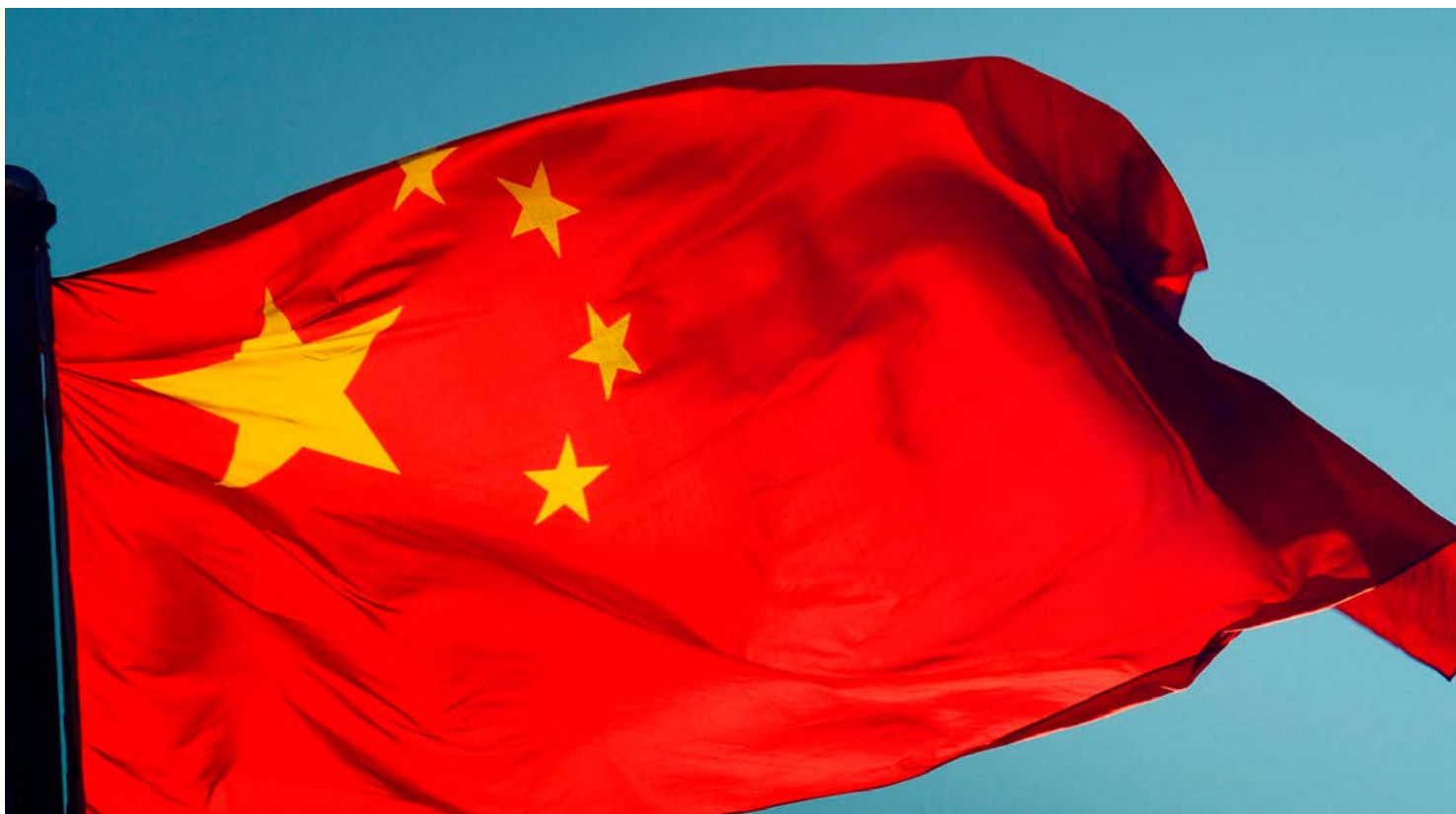
To enhance legalization of export control, the first draft of Export Control Law of China (“2017 Draft”), as an initiative by the Ministry of Commerce, was released in June 2017. It sought public comments.

Since then, the Ministry of Justice, together with other relevant government agencies, have taken the feedback and made further modifications and improvements. The 2019 Draft published by the NPC on its website was subject to a second round of public comments until 26 January 2020. This is considered a formal milestone step in China’s export control legislation process.

Summary of major updates in the draft

The 2019 Draft includes six chapters, covering general principles, control policies and lists, control measures, supervision and administration, legal liabilities, and miscellaneous provisions. These chapters consist of 48 separate articles, which is a reduction from 70 articles in the previous 2017 Draft. While many substantive provisions largely remain unchanged, the 2019 Draft is much more concise for certain major updates, summarized as below:

- ▶ **Purpose of legislation** – the purpose was simply stated in the 2017 draft as “protecting the national security and development interests of



the State," which is revised in the 2019 Draft to "protecting the national security and interests of the State" by inserting an emphasis on "fulfilling international obligations in non-proliferation" in front. Such a notable change indicates China is making controlled efforts, through this new legislation process, not only to protect its own national interests, but more importantly, to fulfil its international commitments.

- ▶ **Control measure** – the 2019 Draft specifies that export business operators "shall" establish their respective internal compliance procedures for export control, which makes it a mandatory requirement as compared to the wordings in the 2017 Draft which "encourages enterprises to establish their respective internal compliance mechanism for export control." In addition, the 2019 Draft is more specific regarding the blacklist-based control mechanism. For example, as per Article 20, it includes the prescribed situations of prohibiting or restricting transactions with entities on the control lists.
- ▶ **Legal liability** – the 2019 Draft empowers the relevant authorities for a better enforcement. For example, as per Article 21 of the 2019 Draft, where an export business operator fails to present the export license or other relevant licensing facilitation certification, Customs is empowered to question on exported goods, request clarification from relevant administration authorities and then take actions as appropriate. Meanwhile, the 2019 Draft provides more severe

punishments on relevant violations. For example, for exporting controlled items without the license, exporting controlled items beyond the permitted license scope or exporting prohibited items, the 2019 Draft increased the penalty from the previous range of RMB50,000 to RMB500,000 to RMB500,000 to RMB5 million, in cases where the illegal business revenue is less than RMB500,000.

- ▶ **Re-export** – the 2019 Draft deletes the re-export provision that was separately listed in Article 64 of the 2017 Draft. Instead, Article 45 of the 2019 Draft incorporates the re-export discussion with "transit, trans-shipment and thorough transportation of controlled items," which covers various situations in more general terms.

Implications to business

Internal procedure

As indicated, Article 14 of the 2019 Draft makes it mandatory for businesses to establish their internal procedures for export control. The change from an encouragement to obligation is a clear indication that China will attach a high importance to export control compliance requirements for exporters to follow. Therefore, businesses are advised to pay close attention to this new development, set up necessary management structures and establish internal procedures for export control as early as possible, according to relevant laws and regulation, as well as the needs from operation.

Control lists

According to Articles 8 and 10 of the 2019 Draft, separate lists would be formalized for dual-use, controlled items and military controlled items by the authority. For items not expressly included in such lists, temporary control can also be imposed for up to two years.

Businesses are advised to, on one hand, make corresponding preparations for possible future control lists/measures, and especially for the exportation to certain sensitive countries or regions. It is also critical to continuously monitor any new developments, to ensure compliance. Such efforts would include evaluation of potential implications for business operation, internal assessment and analysis on controlled items. Companies should also actively participate in the survey by the relevant authorities to avoid unnecessary inclusion of products into the control lists.

Re-export

The definition of re-export in the 2017 Draft was similar to the corresponding concept for US export control purposes. As mentioned above, such a definition is removed in the 2019 Draft, which incorporates the re-export provision with "transit, trans-shipment and thorough transportation of controlled items" in Article 45. It is possible that there could be implementation rules in the future to clarify the applicable compliance requirement, so businesses are advised to keep monitoring regulatory developments in this regard.

Credit system

In conjunction with China's efforts in establishing the nation's social credit system, the provisions of the Draft reflect a similar concept and also the spirit for "offering joint incentives" or "imposing joint punishments" based on a business's credit position in this regard:

- ▶ Article 13 of the 2019 Draft provides that the authority shall conduct comprehensive examination on various aspects of an exporter, including its credit records before making any final license-related decision.
- ▶ As mentioned above, it is suggested in Article 14 of the 2019 Draft that the authority would allow facilitation measures to those with effective control procedures and a good track record when granting the license.
- ▶ If there is any violation, the relevant information (e.g., penalties, etc.) shall be recorded in the nation's social credit system and shared on the information platform. Authorities can reject a license application from exporters who have the record of being subject to penalty. Individuals directly in charge or responsible for the violation will be prohibited from carrying out export business activities for five years, or for life if they are convicted on criminal charges.

With the above, businesses are strongly suggested to maintain a sound record and continuously improve their social credit rating aiming to support stable export operations.

Legal liability

Compared to the 2017 Draft, the 2019 Draft suggests much more severe punishments on violations. Given such, businesses need to attach great importance to export control compliance and increase the awareness of relevant internal and external stakeholders. If there are any doubts on export control issues, such as legal procedures required for relevant items and requirements for license application, businesses shall promptly and actively consult with the administrative authorities of export control or seek assistance from third-party professional organizations. In the meantime, businesses need to consider reviewing whether their business partners have been put on the control lists to reduce the risk of violation and penalties.

Conclusion

While there is still no specific implementation timeline for the 2019 Draft, the release of the 2019 Draft is a milestone for the legal construction of China's export control legislation and shows export control is high on China's priorities list.

China is currently in the transition period before the Export Control Law is officially released and implemented. It is recommended that businesses take this opportunity to enhance compliance awareness of export control, conduct internal training and identify potential risk points in the supply chain in advance. For now, businesses should continue to monitor related legislative and regulatory developments closely. In particular, when the law comes into force, further actions below would be recommended for businesses engaged in export operations:

- ▶ Have in-depth training covering control lists, license requirements and internal compliance procedures for export control and risk prevention mechanism, etc.
- ▶ Establish a comprehensive screening system covering various stakeholders (e.g., banks, service providers, importers, end users and ultimate users) and different business activities (e.g., commercial negotiations, contract signing, technology research and development, manufacturing, supply chain arrangements, and after-sales services)
- ▶ Develop effective risk prevention and control measures as early as possible, aiming to create a more stringent compliance environment in the future and mitigate potential export control risks. ■

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Japan: Annual report on post-entry customs

The Japan Ministry of Finance has released a report in respect of post-entry customs audits that were conducted between July 2018 to June 2019. While the number of audited importers declined slightly compared to the previous year, Japan Customs found that the customs value was underdeclared by more than JPY150 billion – the highest since 2015. In total, Japan Customs assessed JPY14.3 billion in

underpaid duties/taxes and administrative penalties, including JPY43 million in penalties for fraud or gross negligence were JPY40 million.

The top five import categories with the largest underpayment of customs duty and import consumption tax are listed, by HS Chapters, in the table opposite.

Imports (HS chapter)	Duty/tax shortfall (JPY billions)
Electrical equipment (Chapter 85)	3.36
Optical instruments and apparatus (Chapter 90)	2.12
Vehicles and parts (Chapter 87)	1.44
Machinery and mechanical appliances (Chapter 84)	1.15
Organic chemicals (Chapter 29)	0.82

Together, these five chapters account for about 65% of the total duty/tax underpaid duties/taxes. Three of the top five imports have been on the list for the last two years, these being electrical equipment (Ch 85), optical instruments and apparatus (Ch 90), and vehicles and parts (Ch 87). The underpaid duties/taxes for electrical equipment alone amounted to JPY3.3 billion, which is a 35% increase over prior year. Machinery and mechanical appliances (Ch 84) have repeatedly been on the list. On the other hand, organic chemicals (Ch 29) has not been in the top five for several years.

Major examples of customs violations

The report published by Ministry of Finance also highlighted some specific cases where importers were subjected to additional duties. These cases concern two types of violation, being cases not involving fraud or gross negligence and cases that do involve fraud or gross negligence.



Cases not involving fraud or gross negligence

In cases not involving fraud or gross negligence, importers are required to pay the underpaid duties/taxes, as well as administrative penalties, which are generally imposed at 10-15% of the underpaid duties/taxes and interest for late payment.

► Case 1: failure to report price adjustment

An importer of active pharmaceutical ingredients from Country X agreed with the exporter to retroactively review the price of imported goods, which led to additional payments as a transfer pricing adjustment. However, the importer failed to file amended declarations reflecting that these additional payments should have been part of the declaration import value. Due to this oversight, the importer was found to have underdeclared by a total of JPY10.4 billion and was assessed a total of JPY950.2 million in underpaid taxes and administrative penalties.

► Case 2: inappropriate use of EPA tariff rate

An importer of textile articles from Laos declared imports based on the preferential tariff rate stipulated in the Economic Partnership Agreement (EPA) between Japan and the Association of Southeast Asian Nations (ASEAN).¹ However, as the materials used to manufacture the textile articles were procured from a third country, the imported products did not meet the criteria to be considered ASEAN originating. Therefore, they should have been declared to the most favored nation (MFN) duty rate rather than the preferential tariff rate. This resulted in a total liability of JPY16.7 million in underpaid taxes and administrative penalties.

► Case 3: failure to report separate payments for imported goods

An importer of cosmetic containers from Korea made payments to the exporter for assembly costs for the imported products, separately from the invoice price. Whereas such payments should have been included in the customs value, the importer did not declare the payments to customs. As a result, the importer was found to have underdeclared by a total of JPY1.4 billion and was assessed a total of JPY190 million in underpaid taxes and administrative penalties.

Cases involving fraud or gross negligence

In the reported cases involving fraud or gross negligence, importers have declared a customs value based on falsified invoices created by the importer or exporter, this despite the importers being aware of the proper prices of the imported goods. In some cases, importers instructed exporters to create invoices with lower prices for declaration purpose. And in another case, an importer declared a customs value based on an invoice that was created by the exporter, but the importer was aware that the price on the invoice is lower than the proper price. In these cases, the importers were fined with penalties for fraud or gross negligence of JPY40 million in total. Penalty for fraud or gross negligence is generally imposed at 35-40% of the underpaid duties/taxes.

1 Association of Southeast Asian Nations (ASEAN): (current members) Indonesia, Thailand, Singapore, Malaysia, Philippines, Vietnam, Cambodia, Myanmar (Burma), Brunei and Laos.

2 Comprehensive and Progressive Agreement for Trans-Pacific Partnership: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

Implications for importers

The cases highlighted above reinforce the continued importance of declaring customs value in accordance with Japanese Customs Tariff Law. It is important to mention that the failure to report retroactive transfer price adjustment has been reported continuously in the past few years. In Case 1 and Case 3, the importer should have filed declarations to amend the customs value on the original import declarations. Case 2 underscores the challenges of compliance with EPA rules. TPP-11,² the EU-Japan EPA and the US-Japan Trade Agreement have recently entered into force, with all these agreements allowing self-certification of originating status of imported goods. It is crucial for importers to understand and apply correct EPA rules so that use of preferential tariff rates can withstand scrutiny by Japan Customs during post-entry audits and origin verification.

Importers into Japan should be aware that Japan Customs continues to rigorously check and enforce compliance. Audits are regularly conducted, noncompliance is being uncovered and penalties are being imposed. Maintaining appropriate internal compliance mechanisms and processes to ensure compliance with import and export legislation should be a top priority for companies. ■

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Japan: US-Japan Trade Agreement entered into force

The US-Japan Trade Agreement and the US-Japan Digital Trade Agreement was approved by the National Diet of Japan on 4 Dec 2019. Upon Japan completing the necessary domestic procedures, the agreements became effective on 1 January 2020. These trade agreements were signed between two economic superpowers, accounting for approximately 30% of the global GDP. The agreements were negotiated after the United States withdrew from the Trans-Pacific Partnership (TPP). The US-Japan agreements are not as comprehensive as the TPP, and their economic effects are limited; nevertheless, the agreements are still expected to increase trade in goods between the two signatories.

Initial tariff reductions became effective on 1 January 2020. The second reduction became effective on 1 April 2020 for imports to Japan and will become effective on 1 January 2021 for imports to the US, with further reductions phased-in over future years.

Tariffs on products

Japan and the US have stipulated a range of products that will be subject to reduction, or elimination, of customs duties.

(1) Imports to Japan

In the US-Japan Trade Agreement, the customs duties levied by Japan pertaining to agricultural,

forestry and fishery products were set at levels within the scope of those contained in the TPP. Examples include beef, pork, whey and cheese.

One differentiating factor between the US-Japan Trade Agreement and the TPP is that rice has been excluded from the former, meaning that Japan was able to secure protection for its rice industry. Furthermore, no new US-specific tariff-rate quotas were authorized for products already established by the TPP, such as skim milk powder and butter.

Most products will be subject to either staged tariff eliminations or reductions, however, safeguards will be made available when the total import volume of a specific agricultural product – such as beef, pork or whey – exceeds a certain activation threshold.

Furthermore, tariffs on glycerin, peptone, stearic acid and other chemical products will also be reduced. However, Japan has not made concessions regarding taxable industrial products such as iron and steel products and base metal products.



(2) Exports to the US

The existing 2.5% of customs duty for passenger vehicles imported from Japan to the US will remain effective. However, considering further negotiations will be held, there is a possibility of the elimination of tariffs regarding automobile and auto parts. In addition, Prime Minister Abe and President Trump have confirmed that additional tariffs will not be imposed on automobiles and auto parts, pursuant to Section 232 of the US Trade Expansion Act, while the US-Japan Trade Agreement remains in force.

As for other industrial products Japan exports to the US, tariffs will be eliminated or reduced for a wide variety of products. First, high-performance machinery and components, such as machining centers, machine tools, lathes, forging machines, rubber and plastic processing machinery, iron screws and bolts, will be subject to tariff elimination or reduction. Second, materials and equipment necessary for Japanese firms to carry out operations in the US (air-conditioner parts, railway parts, etc.) are also subject to tariff elimination or reduction. Third, state-of-the-art products, whose markets are expected to expand in the future, e.g., 3D printers, TVs and other industrial products, will also enjoy benefits. Since many of these products will become duty free, the agreement is thought to offer great business opportunities to Japanese companies that manufacture such industrial products.

Rules of origin

The US-Japan Trade Agreement also stipulates the rules of origin, being defined in Annex I for Japan and Annex II for the US. To receive tariff reduction

benefits, products must be recognized as originating from Japan or originating from the US in accordance with the defined rules of origin. As mentioned, detailed definitions of the rules of origin for each country are outlined in the respective Annexes, with both countries employing the Change in Tariff Classification (CTC) rule to determine whether a product fulfils “substantial transformation” criteria. Under CTC, a good is considered to be originating where all non-originating materials used in the production of the good, undergo a change in tariff classification at the two-digit (Chapter), four-digit (Heading), or six-digit (Sub-heading) level.

It is critical to determine whether products fulfil “substantial transformation” criteria by confirming the HS code of finished products and their components. In addition, it is important to properly store evidentiary documents to ensure that the content of declarations being filed concerning the origin status is accurate. As with many other Free Trade Agreements, there is a de minimis threshold allowing for some low-value non-originating materials that do not meet the CTC requirement to be used. The de minimis threshold is 10% of the total value of the finished product.

Future developments and the impact on companies

Currently, the provisions of the US-Japan Trade Agreement only include trade in goods. Concessions were primarily made for agricultural products being exported to Japan and industrial products being exported to the US, but not all products are included. It is unclear whether additional products will be included in the FTA. However, some parts

of the US-Japan Trade Agreement do suggest future negotiations concerning reduced tariff (i.e. negotiations concerning the reduction of tariffs on agricultural products exported to Japan, and on automobiles and auto parts exported to the US), so anticipation is that the FTA could be expanded.

In terms of the method of proof for the rule of origin, it is noteworthy that the self-certification system is introduced under the US-Japan Trade Agreement. Importers should pay close attention to the method of declaration and assume that these declarations may subject to review and challenge. Indeed, there is a provision in the agreement that import authorities will carry out verification, so importers must retain documents certifying the country of origin.

Importers will need accurate HS coding of their products to confirm they qualify under CTC rules of origin. This is an area where errors are common, so should be a particular issue of focus as no company would want duties to be imposed on their exports some years after the event. To ensure an effective supply chain in the US-Japan Trade Agreement, businesses should start making actions immediately. ■

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Korea: Developments and changes to free trade agreements

The Korea-Chile Free Trade Agreement (FTA), which was concluded in April 2004, was Korea's first FTA. Korea now has 16 FTAs with 55 countries, as well as preferential trade agreements (PTA), such as the Asia-Pacific Trade Agreement (APTA). As of 2019, the FTA utilization rate is 74.9% for exports and 76.6% for imports. Even with these relatively high utilization rates, the Korean government is still actively supporting the use of FTAs by business. The Korea Customs Service (KCS) is working to expand trade through the use of FTAs, such as counseling experts for corporate FTA use and in addressing various difficulties that companies have faced. We will look at some of these developments in this article.

Korea to ease regulation on direct transportation rule for APTA

The APTA is the oldest PTA among the developing countries of the Asia-Pacific region. It was first enacted in 1976 for the purpose of economic development through trade liberalization and expansion between the developing countries in the Asia-Pacific region. The current member countries are Korea, China, India, Sri Lanka, Laos and Bangladesh. Mongolia has also concluded bilateral negotiations on tariff concessions to become the seventh member.

One of the requirements to enjoy the preferential tariff under the APTA is that originating goods must be transported directly to the destination country. Where goods transit through a country that is not a member of the APTA, it must be proved that the goods have remained within the bonded area under the control of the customs authority of the relevant country without manipulation or further

¹ Through bill of lading is the transport document that is issued by the first carrier to take full responsibility for transportation in all sectors when the goods are transited or transhipped.



processing. In this sense Article 5 of the "Second Amendment to the APTA," Article 9 of the "Operational Procedures for the Certification and Verification of the Origin of Goods" under the APTA and Article 8 of the "Enforcement Rules on Confirmation of Origin" under the APTA stipulate certain documents that can be used to prove that the direct transportation rule has been satisfied, namely: a through bill of lading (B/L)¹, original commercial invoice and the certificate of origin.

KCS used to interpret such documentary requirements in a quite strict manner, allowing preferential claims only when all of the above three documents can be presented, including a "through B/L" for transit in a country that is not a member of the APTA. There was some controversy over this approach, especially as there were large quantities of goods imported from mainland China that were first transported from mainland China to Hong Kong through land transport and imported into Korea by vessels or airplanes, without a through B/L for Hong Kong. With the KCS' narrow interpretation of the above provision, many of such transit cases were not granted the preferential treatment.

In consideration of these difficulties, the Korean government recently amended (10 April 2020) Article 8 of the Enforcement Rules on Confirmation of Origin under the APTA to alleviate such strict interpretation of the direct transportation

rule through a nonmember country. The amended provision states that any one of (i) a through B/L issued in the exporting country or (ii) other documents proving direct transportation of the relevant goods shall be presented to the KCS to prove that the direct transportation rule has been satisfied for the purpose of claiming preferential tariff under the APTA. This means that not only a through B/L, but other documents can also be used now to prove direct transportation of goods traded transit through a nonmember country.

This amendment is preceded by a guideline issued by the KCS in July 2019 concerning goods exported from mainland China through Hong Kong that stated where a through-B/L was not available, a certificate of non-manipulation issued by Hong Kong Customs could serve as proof of direct transportation. The guideline was issued based on a Supreme Court ruling dated January 2019. The dispute was raised by a company after the decision from the customs on their APTA claims, stating that the preferential claim should be rejected due to the non-submission of a 'through B/L'. The first and second trials were concluded in favor of the customs authority, stating that the rule was "based on the Customs Act, which required that all essential documents must be submitted." However, the Supreme Court interpreted differently on the ground that the preferential claims should not be denied due to the formality on the in submission of a through B/L and there was no explicit provision that the preferential claim should not be applied when the through B/L was not submitted. In other words, a through B/L is not an essential, but merely an "exemplary document" under the APTA, and KCS must acknowledge that the direct transportation requirements have been met if the importer has submitted alternative supporting documents, e.g., non-processing/non-manipulation certificate from Hong Kong.

Following this ruling, KCS discussed the issue with the Hong-Kong Customs at the Korea-Hong Kong Origin Cooperation Conference held in May 2019. The Hong Kong Customs agreed to issue a non-manipulation certificate for the cargo departing from mainland China to Korea via Hong Kong. Upon this agreement, KCS issued the above guideline to expand the scope of documents proving direct transportation for application of the APTA.

With the amendment to the Enforcement Rules on Confirmation of Origin under the APTA, companies may now able to claim the APTA preferential rates when importing goods from an APTA country transit through a non-APTA country, even without a through B/L.

Temporary measure of simplified process for FTA application due to the coronavirus outbreak

On 27 April 2020, KCS released guidance on claiming FTA benefits to help companies facing difficulties in obtaining certificates of the origin (COO) from abroad. KCS has extended the retrospective claim period by additional one year (In some cases, totaling two years from the date of imported declaration). Also, the authority has allowed companies to defer payments of customs duties. Importers are now allowed to make the payments within a year of the declaration date. The new guideline can be applied immediately. The authority has not specified when the new guideline will end.

Conclusion

Strict adherence to the FTA rules by KCS has seen many companies challenged in terms of their claiming of FTA preferential duty rates. The Supreme Court ruling was very positive for companies and supports companies in appealing the strict application by KCS. With customs also being flexible around claiming FTA benefits where companies have been impacted by the COVID-19 situation, it is hoped that there will, more generally, be practical application and business supportive decisions by KCS. ■

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Korea: Changes to the customs system

The Korean government has announced measures to promote domestic industrial development as it tries to resolve what was seen as unreasonable discrimination between imported goods and domestic production. Below are two of the actions taken recently.

Update on liquor tax: volume-based liquor tax on beer products

Korea has decided to change its liquor tax system for the first time in 50 years, shifting from a price-based to volume-based system, starting with domestically brewed beer and rice wine.

The Korea Ministry of Trade, Industry and Energy (MOTIE) announced that the liquor tax for beer changed from a value-based system to a volume-based specific tax system 1 January 2020. Under the volume-based liquor tax, any beer, regardless of production cost or retail price, will be subject to the same 830.3 won (72 cent) per liter liquor tax.

The government's decision aims to alter the system that had remained untouched since 1968 to resolve tax imbalances between domestically produced liquor beverages and imports.

Domestic beer companies argued that the existing taxation system discriminated against them, as they sometimes end up paying more taxes than cheaper foreign beers due to the taxing system. Under the value-based system, the liquor tax base for domestic beer included the manufacturing costs, the local SG&A (selling, general and administrative expenses) and the profits. In contrast, the tax base for imported beer only included the import value and the customs duties.

Under the new system, the authority believes that the volume of beer exported to Korea will decrease steadily and the market share of imported beer will also decrease in the Korean beer market. Higher priced products will see the largest decline in liquor taxes.

- ▶ The customs duty, VAT, liquor tax and education tax are normally imposed when importing beer products (HSK 2203.00) to Korea.
- ▶ The liquor tax on draft beer (i.e., beer sold in a container of eight liters or more using an extraction device) is temporarily applied with a reduced rate of 20% for two years.
- ▶ The rate of customs duty and the education tax are to be unchanged with the value-based system.

Tax system	Customs duty	Liquor tax	Education tax	VAT
Value-based (old)	30% (basic duty)	72%	30%	10%
Volume-based (new, as of 1 Jan 2020)	30% (basic duty)	KRW 830.3/ liter	30%	10%

Exemption of customs duties on machineries used in the bonded facilities of small or medium-sized businesses and mid-sized businesses

A bonded factory is a factory or other secured area in which imported dutiable merchandise may be stored, manipulated or undergo manufacturing operations without payment of duty. It is a secured area where the foreign goods or foreign/domestic materials are used to manufacture or further process the goods before being declared domestically to customs. The facility is commonly used by business as it helps to lessen the burden of the payments and promote further manufacturing operations.

A new regulation has been released that allows small and medium sized businesses* (SMBs) and mid-sized businesses** with duty exemption for the imported machineries used in bonded factories. Without the exemption in place, the companies previously had to declare and pay duties on machinery before placement of the machinery in the bonded facility. The regulation aims to promote the use of bonded factories by SMB companies and support for trade manufacturing operations (Effective Date: 1 April 2020-31 December 2022).

* SMBs refer to the companies that meet requirements prescribed by the Tax Special Restriction Act, based on the average sales volume for the three business years, 40 billion to 150 billion won depending on the type of industry.

** Mid-sized businesses refer to the companies with less than 300 billion won of average revenue in three years.

Conclusion

Numerous customs policy decisions, including that around the use of machinery in bonded factories, are trying to support domestic business, but companies doing business in Korea still need to be very aware that the KCS is very compliance focused and any compliance gaps will likely, in the first instance, be met with challenge and assessments. ■

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Malaysia: Open market value for excise duty purposes in the automotive industry

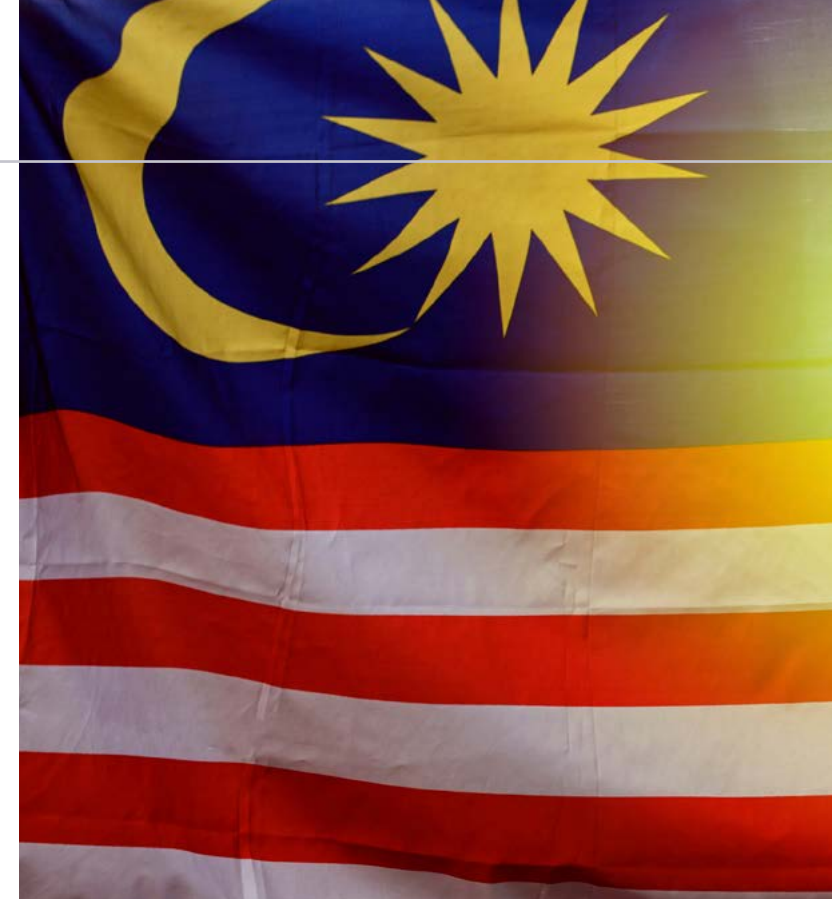
On 31 December 2019, the Malaysian Ministry of Finance (MoF) gazetted the new excise (Determination of Value of Locally Manufactured Goods for the Purpose of Levying Excise Duty) Regulations 2019 (“New Regulation”). This has the effect of introducing a new methodology in the calculation of the open market value (OMV) of locally manufactured vehicles for imposition of excise duty. With excise duty rates on vehicles ranging between 60%-105%, changes to the OMV calculation will influence the single largest cost that automotive manufacturers incur.

The change is in line with the Malaysian government’s continued efforts to meet its obligations to the World Trade Organization’s standards, which is to ensure transparent reporting and a “level playing field” within the automotive industry. The New Regulation that brings about these changes came into effect on 1 January 2020.

Key changes and implications

Expansion cost components included in the OMV calculation

Prior to 1 January 2020, the OMV of a vehicle was determined based on only the cost of manufacturing. With the introduction of the New Regulation, the OMV is expanded to include additional costs, such as selling costs, general expenses and profit margins, this based on either a computed value or flexible value methodology.



Comparison of components of OMV calculation	Before 1 January 2020	Effective 1 January 2020	
		Computed value	Flexible value
Manufacturing costs	Include	Include	If computed value cannot be used, it will be determined in such manner as may be reasonable and in accordance with generally accepted accounting principles in Malaysia
Selling costs	Exclude	Include (e.g., advertising, marketing, sales commission, etc.)	
General and administrative expenses	Exclude	Include (e.g., costs, charges and expenses incurred other than manufacturing and selling costs)	
Margin	Exclude	Include	

The inclusion of these additional costs will result in an increase in motor vehicle prices, as excise duty will be imposed on a significantly higher base amount. However, the MoF has, via a statement on 23 January 2020, confirmed that excise duty will be exempted on costs other than the manufacturing costs for a period of one year from 1 January 2020 to 31 December 2020. In effect, implementation of the new OMV calculation has been deferred for 12 months.

Connected person provisions

The New Regulation has also introduced provisions relating to determining the OMV of a vehicle in sales between “connected persons.” Affected companies are required to identify and ensure that dutiable goods are sold at an arm’s-length price.

Next steps

While MoF has granted an exemption for a 12-month period, it is unclear what will happen thereafter. All options may be possible, whether that be the New Regulation becoming effective in practice, a further exemption being given or, conceivably, that the New Regulation to calculate the OMV is amended.

Certainly, as currently legislated under the New Regulation, an increase in excise tax could have a significant impact to the domestic automobile manufacturing industry, so the exemption period will allow for affected companies to advocate changes to the legislation. In the context that the New Regulation has the purpose of creating a level playing field for imposition of excise tax between domestically produced and imported vehicles, any further developments will be watched carefully.

It should be noted that affected companies are still required to declare detailed costings to the Royal Malaysian Customs Department (RMCD) in respect of the OMV of each vehicle model that is currently being manufactured. These costs will need to be accurately captured and, albeit during the exemption period, the costs will be a reference for RMCD in the future. Therefore, affected companies should take the necessary steps to ensure they comply with the new OMV calculation/reporting requirements to avoid potential future penalties. It will be important for companies to:

- ▶ Review all expense/cost items for compliance with the New Regulations in respect of the OMV declaration submission
- ▶ Assess the accuracy and reasonableness of the expense/cost calculations
- ▶ Identify and review existing transactions relating to the sale of motor vehicles between connected person and assess whether the selling price is acceptable as the OMV, per the New Regulation
- ▶ Assess changes that need to be made to current systems and processes to support compliance with the New Regulation

- ▶ To be aware of any updates and guidance (e.g., terms of reference) released by MoF or RMCD regarding OMV reporting compliance
- ▶ Review historical excise duty reporting for accuracy and completeness
- ▶ Review the company’s (or the group of companies’) existing business structure for operational efficiency in respect of excise tax

Conclusion

With high excise duty rates on vehicles, New Regulation changes will be a cause for concern to the domestic automotive industry. Investment decisions will likely be reviewed and there is the potential that some domestic automobile production may not be viable in the future. With an expanded range of costs to be included in an OMV, companies will need to carefully review their operations and calculations for compliance. Affected companies may seek to advocate for changes to the New Regulations, but companies should also look for efficiencies through planning as a way of mitigating the impact. ■

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Philippines: Update on Post Clearance Audit and the Prior Disclosure Program

Last year, the Philippine Government issued Customs Administrative Order (CAO) No. 01-2019, which addresses the conduct of Post Clearance Audits (PCA) by the Post Clearance Audit Group (PCAG) of the Bureau of Customs (BOC). Included within the Order was implementation of the Prior Disclosure Program (PDP) pursuant to the related provisions of the Customs Modernization and Tariff Act (CMTA). The PDP is designed to encourage importers to come forward and pay deficiency duties and taxes on past importations arising from errors and omissions in goods declaration to avoid steep penalties if the same errors and omissions are found during a PCA.

At the onset, the PCAG was able to immediately raise over USD\$1m in the first quarter of 2019, this representing customs duties and taxes on importations that were remitted or paid by the importers through the PDP. As of February 2020, the PCAG received almost 163 applications for PDP, which generated collections of about US\$46.5m. Viewed as a successful program, the PCAG continues to promote the PDP as a means to efficiently generate additional customs revenues for the government.

Importers should be in no doubt that the PCAG is also keen on implementing the PCA of importers and, as of January 2020, about 307 importers from various industries, such as consumer goods, automobiles, and pharmaceuticals, among others, received audit notification letters (ANL). Under the rules, the applicable penalty for failure to pay the correct duties and taxes on imported goods due to negligence, as determined through the conduct of a PCA, is 125% of the revenue loss.

However, an importer who has received an ANL but applies for a PDP, will be subject to payment of deficiency duties and taxes, plus a reduced penalty of 10% of the basic deficiency, plus 20% interest per year. While an importer who has not yet received an ANL and applies for a PDP, will only be subject to payment of the deficiency duties and taxes, plus 20% interest per year.

The difference in penalty provisions for errors and assessment found under a PCA vs. what would be imposed under a PDP is considerable. Prior to a PCA, or even during a PCA within the period provided under the rules, importers should continue to review and identify possible exposure to deficiency duties and taxes on past importations, as this will help them



determine whether or not applying for the PDP is an option. The expansion of the PCA to more importers is set to continue, so any major importer needs to invest now in addressing their compliance. ■

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Thailand: Customs valuation implication of the new transfer pricing disclosure requirements

In Thailand, the Ministry of Finance (MOF) has been utilizing digital technology to improve the efficiency and transparency of tax collections for all revenue authorities under its control. This is in accordance with Thailand's National Digital Economy and Society Development Plan and Policy for year 2018-2037. Consistent with this national plan is that the Thai Customs Department has been developing its capacity in facilitating international trade and in using big data to analyze imports and exports. This enhances their ability to manage duty and tax collection and in the auditing of companies.

Data sharing between tax authorities

Pursuant to a Memorandum of Understanding between Thai Customs and Thai Revenue Department (TRD) in September 2018, established procedures are in place between both departments for the exchange of information related to taxpayers who are also importers and/or exporters. The MOU was implemented with the support of the MOF to increasingly drive both tax collection agencies into the Digital MOF ecosystem.

New transfer pricing (TP) Disclosure Form requirements

With the introduction of Thailand's new Transfer Pricing Act, taxpayers with related parties in Thailand or abroad are required to file a TP

Disclosure Form with the TRD if its total annual revenue threshold exceeds THB200 million (approximately USD6.25 million). The first batch of filings for the TP Disclosure Form is due by end of May 2020 for taxpayers with fiscal year ended 31 December 2019.

On 12 March 2020, TRD published instructions related to filing of the Form. Specifically, the filing entity is required to make the following disclosures:

- ▶ Name of all related parties in Thailand
- ▶ Name and country of incorporation of all related parties overseas
- ▶ Value each of these related-party transactions with each related party in Thailand and overseas:
 - ▶ Operating revenue
 - ▶ Other income
 - ▶ Purchase of raw materials
 - ▶ Purchase of land, building or equipment
 - ▶ Royalty fee
 - ▶ Management fees, technical services, commission fees
 - ▶ Interest expense
 - ▶ Other expenses
 - ▶ Borrowing as at end of accounting period
 - ▶ Lending as at end of accounting period





- ▶ Impact on revenue, costs and gross margin if filing entity underwent business restructuring with related parties
- ▶ Sale or transfer of intangible property by filing entity to related parties

Customs valuation implications to importers

Clearly, several of the disclosures required under the new TP disclosure requirements are ones that will be of great interest to Thai Customs. Royalties and commission fees are commonly viewed as the “low hanging fruit” for duty assessments by customs auditors. With the added TP disclosure on related-party transactions and with the existing information exchange protocols in place between both tax

collection agencies, taxpayers can expect enhanced risk-profiling of importers by Thai Customs and more rigorous customs valuation audits going forward as the authorities step up on tax collections.

Taxpayers with significant related-party transactions should review the additional data and information disclosed and assess whether it presents any customs undervaluation risks in terms of:

- ▶ Unreconciled discrepancies between the reported values of purchases against customs values declared on imports
- ▶ Whether reported non-trade costs/payments such as royalty, commissions or brokerage fees are dutiable and should be added to the customs values declared

- ▶ Whether the value or costs of any goods (materials, components, parts, tools and dies, etc.) or services (engineering, development, design, plans and sketches) borne by importer and supplied directly or indirectly for the production and sale for export of imported goods have been included in the customs values declared

Extension of the “One-Stop Service” program for voluntary disclosures

In the event of any errors in the declaration of customs values, taxpayers may consider the option for self-disclosure to correct past import entries and settle the outstanding duty and import VAT.

In a normal course of business, a taxpayer could make a self-disclosure at each port of import. With such a declaration, the port officials can use their own discretion on whether to collect a customs penalty. This would be determined on a case-by-case basis.

Fortunately, Customs has recently announced that its “One-Stop Service” program (OSS), which was due to expire on 30 April 2020, has been extended and is effective from 1 May 2020 until 30 September 2021. This OSS program allows the taxpayer to come forward to self-declare and correct past declaration errors. Subject to conditions under the program, qualified importers are able to settle their outstanding duty liability at a single contact point at Thai Customs HQ, without a need to approach the officials at each port. Customs will waive duty penalties and levying duty surcharges at reduced rates for eligible taxpayers who participate in this program. However, taxpayers will still be subject to VAT surcharges and VAT penalties.



The duty and VAT penalties and surcharges applied to a taxpayer under customs audit vs. OSS program vary as follows:

Additional liability	Under customs audit	Under One-Stop Service Program
Customs penalty	Generally, 2 x duty shortfall	Waiver
Customs monthly surcharge (capped at 100%)	1%	Up to 1 year: 0.25% 1 to 2 years: 0.5% 2 to 3 years: 0.75% More than 3 years: 1%
VAT penalties	100% of VAT shortfall	100% of VAT shortfall
VAT monthly surcharge (capped at 100%)	1.5% monthly	1.5% monthly

We have seen the trend that more taxpayers have utilized the OSS program to address the duty and tax liability in respect of errors in tariff classification, mis-use of duty benefit under free trade agreements, and customs valuation. Issues have been successfully settled with customs via this OSS Program.

Conclusion

The situation is clear. More and more data is being collected by the tax authorities, this data is then being shared among the tax authorities and, increasingly, the tax authorities are using this data to target companies and enhance how they conduct audits. Understanding this, and particularly in the context of the recent additional TP disclosures, the OSS program being extended provides a good opportunity for companies to review any areas of noncompliance and proactively settle the liability with customs. ■

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EU: New tools to enforce rights in international trade and trade war countermeasures

In these times of trade tensions, the European Union (EU) has announced a new tool to enforce its rights in international trade in the absence of a fully operative World Trade Organization (WTO) dispute settlement system.¹ Furthermore, the EU adopted new countermeasures against certain products originating in the United States (US).

On 12 December 2019, the European Commission unveiled a [proposal](#)² (COM(2019) 623 final, in the form of an amendment to the existing regulation (EU) No. 654/2014 (the Enforcement Regulation)) that will allow the EU to “protect its trade interests despite the paralysis of the multilateral dispute settlement system in the WTO.” The Commission has also created the position of Chief Trade Enforcement Officer.

EU Commissioner for Trade, Phil Hogan, said: “This is a critical moment for multilateralism and for the global trading system. With the Appellate Body removed from the equation, we have lost an enforceable dispute settlement system that has been an independent guarantor that the WTO's rules are applied impartially. Whilst we seek to reform the WTO and re-establish a well-functioning WTO system, we cannot afford being defenseless if there is no possibility to get a satisfactory solution within the WTO. The amendments we propose will allow us to defend our companies, workers and consumers, whenever our partners do not play by the rules.”

¹ See our 'WTO's Appellate Body disbands' article from [TradeWatch 01/2020](#)

² https://ec.europa.eu/commission/presscorner/detail/en/ip_19_6748

The EU's proposal is to amend the existing Enforcement Regulation. The current regulation, a basis under EU law for adopting trade countermeasures, requires that a trade dispute goes all the way through the WTO procedures, including the appeal stage, before the EU can react. The Commission's proposal will therefore enable the EU to react even if the WTO is not in a position to deliver a final ruling. The new mechanism will also apply to the dispute settlement provisions included in regional or bilateral trade agreements to which the EU is party. If adopted, the new arrangement will allow the EU to impose countermeasures against other states' products in cases where the WTO dispute panel sides with the EU, and the state being party in the dispute appeals to the "paralyzed" WTO Appellate Body. Further information is available in this [memo](#).³

New EU measures against the US

On 24 January 2020 the US adopted safeguard measures in the form of a tariff increase on imports of certain derivative aluminum products and certain derivative steel products, effective from 8 February 2020, with an unlimited duration. In response to these measures the EU will impose as of 8 May 2020 additional import duties of 20% on products of CN code 9613 80 00 (certain lighters) and of 7% on products of CN code 3926 30 00 (fittings for furniture, coachwork, used in car manufacturing) originating in the US (Implementing Regulation (EU) 2020/502).

Impact for businesses

Companies that conduct any form of international trade should closely monitor WTO Appellate Body updates and consider long-term impacts to their businesses. Countries that have not negotiated bilateral trade deals containing dispute resolution mechanisms will now find themselves without an independent means for resolving their problems with each other. If the UK leaves the EU on 31 December 2020 with no free trade agreement, the UK would then be trading with the EU on WTO terms, including the imposition of tariffs and quotas from 1 January 2021. Should disputes arise with the EU (or other territories with whom the UK has yet to agree a free trade agreement), the UK may be in a weaker position. ■

³ https://ec.europa.eu/commission/presscorner/detail/en/QANDA_19_6757

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EU: Revamp of EU Excise Directive



The EU Excise Directive lays down the general arrangements for excise duty, with particular emphasis on the production, storage and movement of (i) energy products and electricity, (ii) alcohol and alcoholic beverages and (iii) manufactured tobacco (hereafter, “excise goods”) between EU Member States. The goal of the EU Directive is to allow the free movement of excise goods while at the same time ensuring that the correct tax debt is ultimately collected by the EU Member States.

Following an evaluation of Council Directive 2008/118/EC by the EU Commission in the framework of the EU Regulatory Fitness and Performance (REFIT) program, certain areas of improvement were identified. As outlined below, the main areas are the improvement of the interaction between excise and customs legislation, as well as the automation of intra-EU movement of excise goods that have been released for consumption.

With Council Directive (EU) 2020/262, published by the EU on 27 February 2020, we are up for a third recast of the Excise Directive since the establishment of the EU in the early nineties. It follows the existing objectives to ensure the smooth functioning of the internal market and the need to ensure effective taxation.

Main takeaways

A. Alignment of excise provisions with customs provisions

Besides replacing obsolete references to customs legal provisions and terminology with the current terms from Regulation (EU) no 952/2013 (hereafter, “Union Customs Code”), the recast aims to streamline the interaction between excise and customs procedures and introduces new obligations for declarants when excise goods are imported into and exported from the EU.

- ▶ **Import:** new obligation for the declarant to provide the unique excise number of the consignor and the consignee in the customs declaration, enabling the competent authorities in the Member State of importation to ensure that the evidence for claims for exemption from paying excise duty on import are consistent with the details submitted via the computerized system (hereafter, “EMCS” – Excise Movement Control System).
- ▶ **Export:** new obligation for the declarant to provide a unique administrative reference number (hereafter, “ARC”) when the export declaration is lodged and accordingly ensure that there is an excise guarantee available for the movement of excise goods.

The customs office of export will subsequently verify whether or not the data of the e-AD corresponds to the export declaration. If so, the goods can be released for export.

Additionally, the use of the external transit procedure whereby (excise) goods lose their customs status of Union goods (i.e., T2 goods will become T1 goods), will allow that the transit system (hereafter, "NCTS" - New Computerized Transit System) takes over from EMCS the monitoring and supervision of non-Union excise goods transported between the customs office of export and the customs office of exit. This interaction between customs and excise systems, will provide benefits to the fight against fraud and in securing the excise debt.

B. Duty paid excise procedures

► B2B – Going digital

EMCS, which is currently used to monitor the movement of excise goods under duty suspension, shall be extended to the movement of excise goods that have been released for consumption (i.e., duty paid excise procedure) in one Member State and are moved to another Member State to be delivered there for commercial purposes (i.e., B2B transactions). Where the 2008 Directive states that a Simplified Administrative Document (hereafter, SAAD) is needed for goods on which duty had been paid in the Member State and then moved to another Member State for commercial purposes,¹ the recast Directive now states that the movement of these excise goods shall take place under cover of an electronic simplified administrative document, processed in EMCS.

The recast accordingly introduces two new economic operator roles to allow for the identification in EMCS: (i) the "certified consignor" and (ii) the "certified consignee." To make use of duty paid B2B movements, an economic operator meaning to dispatch excise goods in EMCS will need to be registered as "certified consignor." At the receiving side, the economic operator will need to be registered as a "certified consignee."

Moving from a paper-based system (SAAD) to an electronic process will, inter alia, facilitate the excise duty reimbursement process that is currently perceived as burdensome and discriminatory because of variations between national requirements.

► B2C – Use of fiscal representation

With regard to distance selling – *where excise goods are acquired by individual persons who do not carry out an independent economic activity and where those goods are dispatched or transported by a consignor who carries out an independent economic activity (i.e., B2C transactions)* – the recast now introduces the option for operators to use or not use a tax representative, to comply with excise obligations, like for example, the guarantee settlement and record keeping in the Member State of destination. The possibility for a Member State to force the use of a tax representative gets this way deleted.

► Liability clauses

In addition to the computerization and the changes to the use of tax representation, the liability provisions for the holding and storage

of unpaid excise goods outside an excise duty suspension arrangement have been broadened. The recast Directive introduces the possibility for Member States to hold liable a combination of persons to pay excise duty in accordance with the principle of joint and several liability. The worldwide increase of both B2B and B2C e-commerce, as well as the involved platforms, requires the national authorities to hold liable all operators somehow involved with any of the observed irregularities.

C. Common partial loss threshold

A new paragraph specifically focusses on a common partial loss threshold for the movement of excise goods under an excise duty suspension arrangement between EU Member States. Although, the 2008 Directive already provides for EU Member States to lay down its own rules and conditions, under which losses due to the nature of excise goods (i.e., volatile energy products and alcohol, like for example, the evaporation losses for gasoline transported in bulk) are allowed, there is no uniform treatment throughout the Union.

The EU Commission recently published a report, indicating the different EU allowances applied. To illustrate, in Belgium and Luxembourg a movement is deemed to be "regular" and no excise duties become due – unless fraud is expected – whenever the shortages mentioned in the report of receipt are between 0.2% and 2%, depending on the

¹ As also established in the Commission Regulation (EEC) No 3649/92 on a simplified accompanying document for the intra-Community movement of products subject to excise duty which have been released for consumption in the Member State of dispatch.

type of energy product. Whereas Belgium and Luxembourg provide for tolerance thresholds in their national legislation, the Nordic countries (Denmark, Finland and Sweden) do not provide for any fixed tolerance levels. Hence, the “regularity” of a particular movement has to be analyzed on a case-by-case basis, causing legal uncertainty with economic operators.

With the provision on a common partial loss threshold, the EU Commission gets delegated to determine a common partial loss threshold as a percentage of the total quantity and other relevant aspects to the transport of goods, having regard to among others: (1) the nature of the goods, (2) the physical and chemical characteristics, (3) the ambient temperature and (4) the distance or time consumed during the movement.

Whereas the tolerance thresholds, covered by the recast Directive, are limited to the transport of excise goods under a duty suspension arrangement; EU Member States are still allowed to lay down its own rules for the treatment of partial loss for any other arrangements (e.g., partial loss for storage under a suspension arrangement).

Timeline

EU Member States shall implement the required amendments in their national laws and apply them by 31 December 2021. However, as a transition rule, the receipt of excise goods outside the EMCS system will still be allowed until 31 December 2023.

Actions for business

Economic operators dealing with excise goods should consider upcoming changes to the national excise provisions. Companies involved with the duty paid movement of excise goods, should consider future excise registrations which, among others, will simplify and harmonize the reimbursement procedure for excise duties between EU Member States. At the same time, liability provisions in case of irregularities should be closely monitored both from a legal and commercial point of view. Whenever the product’s nature you are commercially involved with results in e-AD shortages, like for example, petrol evaporation, EU harmonization of tolerance levels may lead to opportunities/costs depending on the markets companies are active. ■

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GCC: How to navigate global trade controversy and disputes

Customs controversy is becoming more prevalent in the Gulf Cooperation Council (GCC) region, and importers are beginning to face increased pressure to readily have a well-integrated and fully aligned post-clearance audit (PCA) and customs controversy strategy in place. The stages of controversy include risk mitigation, controversy management and controversy resolution. Importers in the region may begin to realize that an integrated PCA and controversy resolution strategy would have to include risk mitigation tactics to achieve compliance as best as possible prior to any audit; controversy management tactics to swiftly respond technically and adequately to any incumbent controversy, and controversy resolution tactics to pursue all possible recourses at the various levels of dispute resolution in the relevant GCC country.

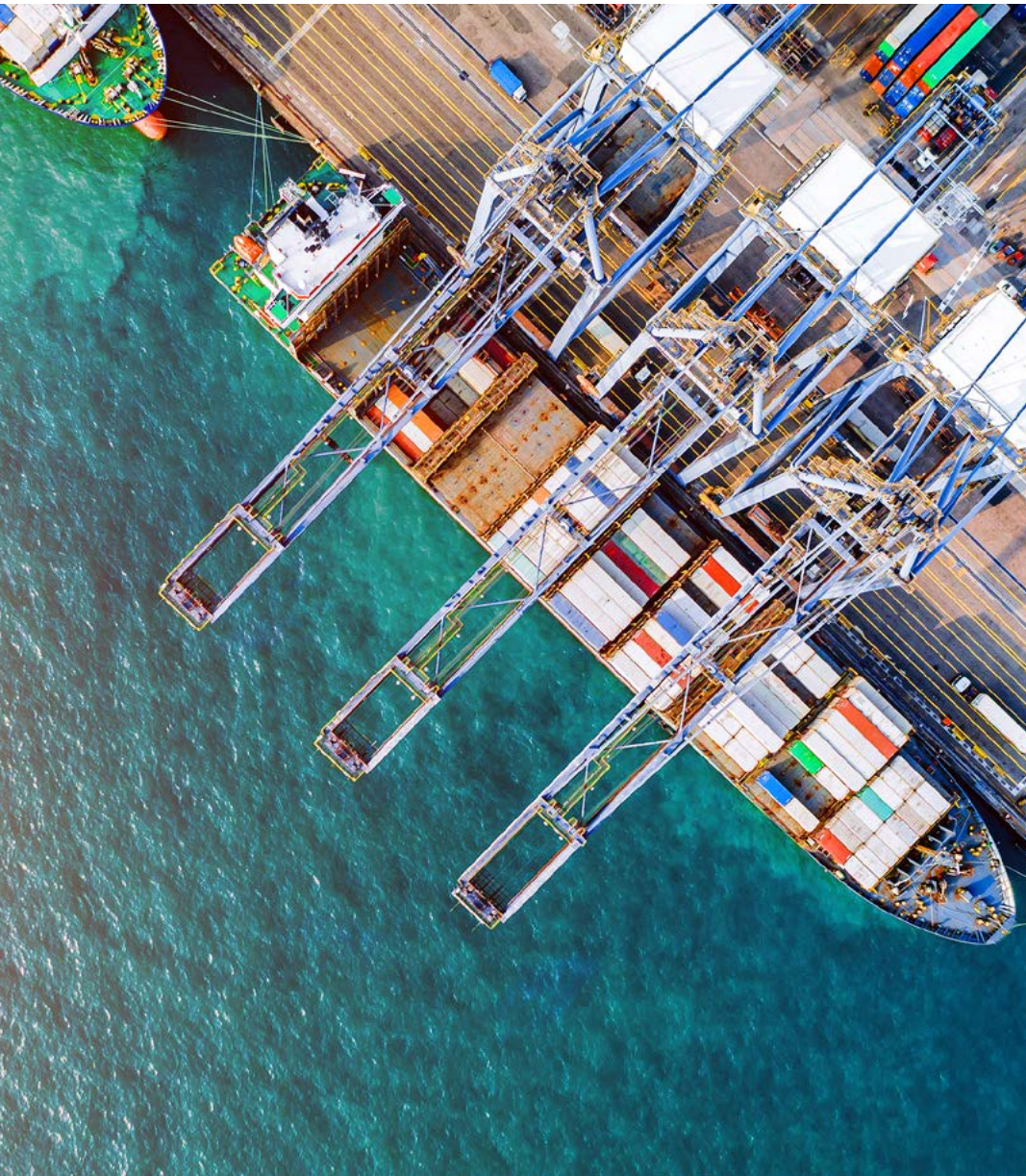
Over the past two years, the focus and investigative capacities of customs authorities in the GCC region have rapidly become more robust, impacting on the revenue, day-to-day financial transactions and supply chain operations of importers in the region. Additionally, GCC countries (The Saudi Arabian Customs Authority, in particular) have recently developed and launched extensive PCA programs supported by significant numbers of dedicated officers targeting major and high duty importers. GCC customs authorities are also relying on advanced data analytics and artificial intelligence to help identify quick wins and are establishing PCA targeting committees comprised of senior management to identify potential companies to audit.

For example, The Saudi Arabian Customs Authority has within 12 months of transforming its PCA function managed to increase its performance by 24 times, conduct more than 400 audits and revamp its internal capabilities.



Based on these new capacity developments, it is highly probable that the GCC customs authority will identify and challenge any customs practices perceived to be noncompliant and impose potentially severe punitive action. Though customs authorities in the GCC region are revamping their PCA functions, the operations of PCA in the region still present challenges. Based on experiences in the region and feedback from clients over the past two years, we have observed the following developments:

- ▶ The key areas of revenue assessments have been on the technical issues of preferential treatment in free trade agreements (GCC and the Greater Arab Free Trade Area, GAFTA), customs valuation and tariff classification.
- ▶ Targeted industries have included the electronics, tobacco, life sciences, consumer products and oil and gas industries.
- ▶ Major distributors have been audited from the perspective of their multiple multinational clients.



- ▶ Currently, PCA auditors are becoming better equipped with data analytics and financial and accounting backgrounds. PCA questions are becoming more focused and advanced.
- ▶ PCA audit visits are sudden, with one to two days' notice of an audit site visit with request for voluminous documents or information before the visit.
- ▶ Deadlines and timelines for submission of documents, responses or appeals can be very short. Importer accounts may be suspended by customs officers until information is provided (thus interrupting import operations).
- ▶ Importers must rely on making a compelling case supported by documentary evidence.
- ▶ Engaging in close technical discussions with officers before an audit outcome may help to mitigate the audit findings and pursuant controversy.
- ▶ Importers underestimate the seriousness and risks of the audit process and potential duty demand amounts that can be levied from such audits.
- ▶ Penalties may be applicable even in cases where the importer has approached the customs authority and self-reported the noncompliance.

There are recognized benefits for GCC importers in implementing an integrated and proactive approach to customs audits and controversy resolution. As every step taken in a PCA investigation and the pursuant controversy process could potentially have a direct and significant financial impact on GCC importers, importers should review and assess their operations and strategies to best minimize risk, avoid disputes or pursue adequate legal recourse where necessary. ■

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Saudi Arabia: Compliance with product conformity obligations now easier and faster

Saber is a system launched by the Saudi Arabian Standards, Metrology and Quality Organization (SASO) that requires importers and manufacturers to electronically issue product Certificates of Conformity (CoC) and Certificates of Shipment (CoS), certifying that the products conform with SASO standards and may be shipped to Saudi Arabia. Through the Saber platform, suppliers and importers are connected with conformity testing and certifying bodies that have been preselected and approved by Saber to conduct conformity tests on any products to be sold in the Saudi Arabian market.

With very limited exceptions, every importer intending to import products and every local manufacturer intending to sell products in Saudi Arabia must register on the Saber platform for product approval before import and sale in Saudi Arabia. Only after the CoC and CoS are issued may the product be imported and sold in Saudi Arabia. Without the certificates, the product will not be allowed to be imported or, if manufactured locally, may not be sold in Saudi Arabia.

To comply with Saber requirements, importers are required to do the following:

- ▶ **Register an account**
Importers are required to register an online account, submit details and identify relevant certifying bodies it will nominate.
- ▶ **Register each product requiring conformity and apply for Certificate of Conformity**
Each product's details must be registered and uploaded in advance before an actual CoC is requested. The importer will subsequently be allowed to request assessment and obtain a CoC from the relevant certifying body. Information required is technical and includes product grouping, pictures, trademarks, tariff classification details and interaction with the manufacturer and certifying bodies. A CoC is valid for one year and a single CoC may be used for multiple shipments.
- ▶ **Obtain a Certificate of Shipment for each shipment**
There is no limit on the quantity that may be shipped on a single CoS. If the shipment is from two different countries, the importer will require two different CoS. The CoS is valid for three months, but this period might soon be shortened. The certificate expires once the related goods land in Saudi Arabia.



While the process is intended to facilitate compliance and might seem simple at first glance, some local importers and distributors may experience difficulty using the system and requests may be rejected. Furthermore, multiple requests from multinational businesses globally may require in-depth clarifications as to the specific nature of their business scenarios, imported products, certifying bodies and classifications of goods. This results in added administrative costs, delayed shipments and delayed revenue.

Businesses with import or manufacturing operations in Saudi Arabia should consider mitigating any Saber-related processing difficulties, costs or delays by mapping and assessing their operations to efficiently navigate and comply with the Saber requirements. ■

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South Africa: The treatment of retroactive transfer pricing adjustments by the South African Revenue Service

The impact of retroactive transfer pricing adjustments on the customs value of imported goods has recently been a focus of the South African Revenue Service's (SARS) Customs Division. This came about as a result of the realization that some taxpayers were not compliant with the legislative requirements in this regard.

Legislative requirements

Customs matters are dealt with in terms of the provisions of the Customs and Excise Act 91 of 1964 (the Customs Act). The methods of customs valuation are defined in the Customs Act with the primary method being the transaction value method. Valuation under this method relies on the price actually paid or payable for the goods when sold for export. Where the importer and exporter are related entities, this amounts to the arm's-length price determined by the relevant transfer pricing policy (as reflected on the export invoice).

In cases where the prices between related entities do not result in an arm's-length remuneration, a retroactive transfer pricing adjustment may be required. These adjustments result in either a

reduction or increase in the price of goods sold between the related entities.

Where transfer pricing adjustments, relating to the sale of physical goods, are made between such related entities, the price paid for such goods are affected. An adjustment to the price paid by an importer accordingly also effects the customs value of the goods previously imported (especially where the transaction valuation method is used). The value previously declared to SARS upon importation of goods into South Africa may accordingly not be correct.

The importer therefore has an obligation to notify SARS Customs of any transfer pricing adjustments that have been made (be it through a debit or credit note) after the importation of goods into South Africa, to the extent that it related to the imported goods. This notification must be made to SARS Customs within a month of the importer receiving the debit or credit note.

Upon realization of the correct value of the imported goods, SARS will call upon the importer to bring into account any outstanding duties because of the



retroactive transfer pricing adjustment (where the price of the goods is increased).

SARS Customs' treatment of retroactive transfer pricing adjustments

SARS recently issued a media statement announcing that resources would be invested into the enforcement of the legislative requirements and the compliance of taxpayers in this regard. We have noted in practice that this includes the imposition of hefty penalties on noncomplying taxpayers.

SARS Customs has further been working closely with the SARS Transfer Pricing Department in relation

to conducting audits and sharing information, to identify such noncomplying taxpayers more efficiently. Of noteworthy importance, the audits conducted by SARS in this regard, may in practice, date back up to five years.

Obligation on taxpayer to ensure compliance

It is therefore important for taxpayers to ensure compliance with the legislative provisions before SARS conducts an audit on such taxpayers and discovers the noncompliance itself. In this regard, taxpayers must ask themselves the following questions:

1. Has the taxpayer historically made any transfer pricing adjustments?
2. Were these transfer pricing adjustments related in any manner to the goods imported during the period to which the transfer pricing adjustments relate?

If the answer to both questions is yes, the taxpayer will be obliged to comply with the law by notifying SARS of such transfer pricing adjustments within one month of the importer receiving the debit or credit note.

Where it is found that the taxpayer had an obligation to submit a customs value adjustment to SARS, but failed to do so, the taxpayer has an obligation to notify SARS of the noncompliance and further remedy the noncompliance by submitting the customs value adjustments to SARS. ■



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UK: Brexit update

Until the end of December 2020, the United Kingdom (UK) is in the “transition period,” which means that – while it is not a European Union (EU) Member State – the UK remains bound by EU law and all obligations stemming from EU international agreements, as well as being viewed as an EU Member State for the purposes of EU legislation.

▶ **Third countries with EU agreements and the UK during the transition period**

While the UK remains bound by obligations stemming from EU international agreements, third-country partners to these agreements are not bound by the same obligations.

However, the EU has notified other parties to its international agreements that the UK is to be treated as an EU Member State for the purposes of these agreements during the transition period, and this treatment has been accepted by most, if not all the third countries in question.

The intention of both the UK and EU is that a free trade agreement (FTA) shall be agreed by the end of the transition period, allowing for some level of reduced disruption at that point for impacted traders.

Negotiation progress

In February, both the UK and EU published their mandates for future relationship negotiations. These set out each side’s opening positions for the negotiations and act as instructions for the negotiators.



Following this, the first round of negotiations between the two parties took place from 2 to 5 March in Brussels.

Due to the COVID-19 pandemic, second round negotiations, scheduled for 18 to 20 March did not take place. However, on 18 March, the European Commission (EC) did publish a draft treaty text. The UK Government has also tabled a draft text, which was made public on 19 May.

In response to the cancellation of the second-round negotiations, the UK and EC held following negotiating rounds via videoconference, beginning 20 April.

Extending the transition period

Due to the delays driven by the cancellation of the second-round negotiations, some commentators and businesses have called for an extension to the transition period to increase the chances of an FTA being in place prior to the end of the transition period.

However, in April, the UK Government made a statement explicitly stating that they will not ask the EU to extend the transition period and would reject an EU request for transition period extension.

Following this, on 12 June, the UK cabinet office confirmed that the UK has formally notified the EU that the UK will neither accept nor seek any extension to the transition period.

On this basis, the transition period will end on 31 December 2020.

Once the transition period ends

If no extension of the transition period is agreed, then from the start of January 2021 EU law will no longer apply to the UK.

Whether or not there is an FTA agreed at that point, it is anticipated that there will be a customs border between the UK and the EU. This will necessitate some customs formalities for goods moving between the UK and the EU.

For imports into Great Britain (GB) from the EU, the UK Government has **announced**¹ that:

- ▶ **From January 2021:** Traders importing standard goods, covering everything from clothes to electronics, will need to prepare for basic customs requirements, such as keeping sufficient records of imported goods, and will have up to six months to complete customs declarations. While tariffs will need to be paid on all imports, payments can be deferred until the customs declaration has been made. There will be checks on controlled goods like alcohol and tobacco. Businesses will also need to consider how they account for VAT on imported goods. There will also be physical checks at the point of destination or other approved premises on all high risk live animals and plants.
- ▶ **From April 2021:** All products of animal origin e.g., meat, pet food, honey, milk or egg products, and all regulated plants and plant products will also require pre-notification and the relevant health documentation.
- ▶ **From July 2021:** Traders moving all goods will have to make declarations at the point of importation and pay relevant tariffs. Full safety and security declarations will be required, while for sanitary and phytosanitary (SPS) commodities there will be an increase in physical checks and the taking of samples: checks for animals, plants and their products will now take place at GB border control posts.

As such, traders should be preparing accordingly.

If an FTA is agreed, then quota-free preferential duty rates (likely zero) will be available to traders who can prove the originating status of the goods from the partner country – if origin cannot be proved, then full duty rates will be levied.

If an FTA is not agreed, then payment of customs duties and other border taxes will be required for movements of goods between the UK and EU.

Most Favored Nation (MFN) Duty rates for imports into the UK are set out in the UK Global Tariff, released by the UK Government on 19 May. This tariff will come into effect from the end of the transition period. Meanwhile, MFN imports into EU countries will continue to be subject to the existing EU Common External Tariff.

Preparing for the end of the transition period

As outlined above, by 1 July it should be clear whether or not the end of the transition period will be at 31 December 2020. This will impact the validity of previous planning activities, and as such, impacted businesses should be performing some readiness activities now.

From 1 July, there are six months up until the end of the transition period if no extension is agreed. This is a short timeframe, and as such businesses should be preparing now for timely action in July.

Therefore, businesses can now focus on three initial objectives to enhance preparations from July:

1. Response team in place

Since the initial Brexit planning process, internal responsibilities and parameters may have changed. Consequently, there should be a clear set of roles and responsibilities surrounding planning to control and coordinate preparation activities.

2. Internal touchpoints scheduled

Ensuring that the relevant stakeholders are engaged, and that current preparation status is understood will require an established internal schedule to ensure progress and tracking.

3. Revaluation of existing Brexit plan

Many businesses have previously planned to mitigate the impacts of the UK's exit from the EU. In light of the changing parameters, such as the new UK Global Tariff, these plans will likely need to be adjusted/revaluated. ■

UK Government funding for Customs training

to help your business prepare for the UK leaving the EU is still available until January 2021 (or until it runs out). See [here](#) to sign up and for more information on locations, dates/timings, agenda and the links to the government grant.

Brexit: why now is the time to reassess all previous plans – [webcast 24 June 2020](#)

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¹ <https://www.gov.uk/government/news/government-accelerates-border-planning-for-the-end-of-the-transition-period>

Technology



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EY trade analytics – visibility is key



The global trade environment is becoming increasingly challenging. Existing tariff tensions and protectionist policies have now been augmented by the global COVID-19 crisis. Established supply models and trade relationships are being disrupted. The resulting uncertainty has meant that the costs and risks associated with global trade are growing and becoming more difficult to control.

In this midst of uncertainty, it is vital for companies to have visibility of their global trade footprint. Having trusted data in the area of cross-border trade allows them to see what they pay and where, to identify costly compliance risks and supply chain delays, as well as uncover potentially significant cost savings that go directly to the P&L.

Visit [ey.com](https://www.ey.com) and watch the video under 'EY Global Trade Analytics'.

Our trade analytics offering

The EY Global Trade team has developed an advanced trade analytics offering that can provide companies with the transparency they need to take the informed decisions necessary to navigate through the current disruption.

EY Trade Analytics utilizes governmental, broker and client ERP data to give global visibility to import and export activities, with the ability to drill down to individual country views. This gives our clients a detailed and comprehensive view of their duty costs and end-to-end supply chain, allowing them to:

- ▶ Quantify total duty paid by country and globally
- ▶ Identify areas of duty reduction to minimize landed product and material costs, such as via free trade agreement optimization, availability of special customs regimes, elimination of unnecessary valuation elements
- ▶ Configure current and potential future supply chains to model the impact for current and future trade disruption
- ▶ Analyze tariff classifications to detect anomalies and ensure tariff-driven import approvals are in place to streamline compliance and customs clearance

The EY Global Trade team has extensive experience to support clients as they seek to convert this visibility into value by implementing and operationalizing the cost-savings and risk mitigations identified by the EY Trade Analytics offering.

How technology can help you manage trade disruption and navigate the challenges of COVID-19

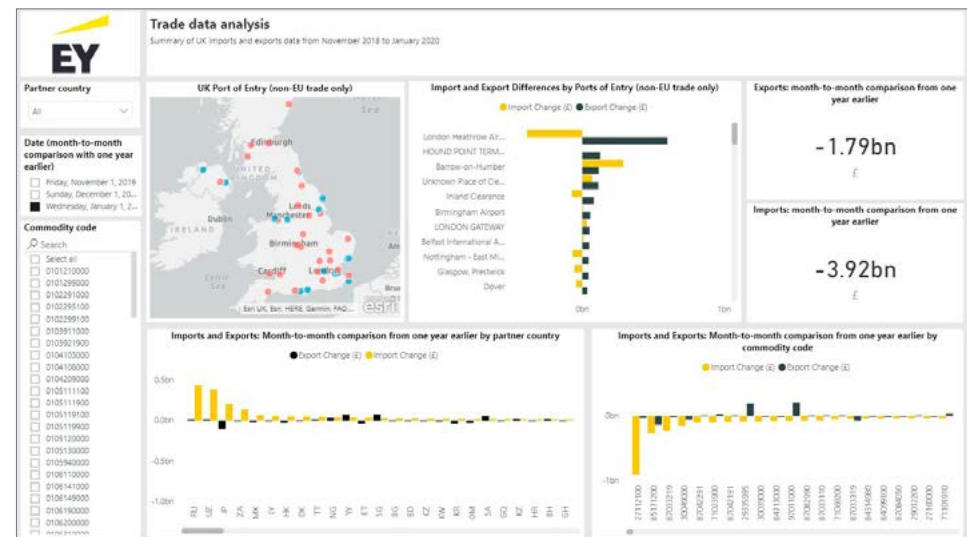
Over the past few decades, the trend of globalization has moved organizations toward highly interlinked, dependent supply chains. However, geopolitical tensions (e.g., Brexit, US-China trade dispute, etc.) and the current COVID-19 pandemic have shown us how fragile and vulnerable supply chains have become.

Generally, disruption to trade is not something new. However, our ability to understand businesses and trade flows has changed dramatically over the past decades thanks to technology and what it can show us. We can assess what companies are moving around the world, what countries are importing and

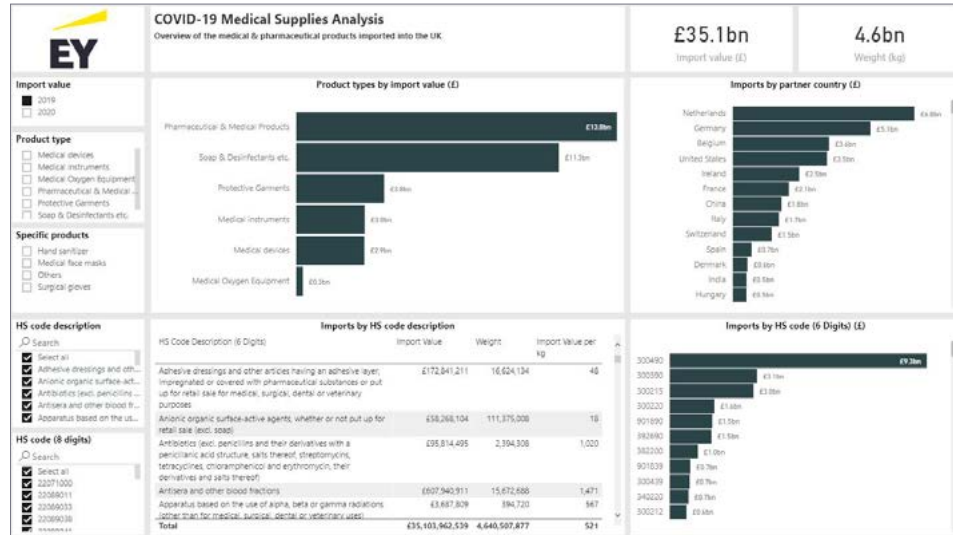
exporting, what the prevailing manufacturing capacities are, what potential and actual logistical bottlenecks may be – all by using readily available data.

The amount of data available on not just your own company but for countries' total imports and exports has never been greater. Through the use of advanced analytics and data visualization (see our [EY Trade Analytics article and video](#) (page 62 of this publication) we can now not only better prepare and manage trade disruption, but we can also highlight potential advantages and simulate various different scenarios.

Undoubtedly the largest disruption to business and correspondingly trade in recent years has been COVID-19. The pandemic has swiftly spread across the globe and disrupted supply chains throughout the world, causing shortages we have all felt personally, as well as businesses as we try to work through these challenging and unprecedented times.



The issues posed by COVID-19 to supply chains include closed borders, lack of staff to process and manage shipments, controls on movements of certain goods, lack of demand for goods such as for oil, increase demand for others such as PPE equipment, lack of containers to move goods, and more.



How businesses exposed to supply chain disruptions have reacted and continue to react to this pandemic has differed substantially depending on a number of factors. Those reliant on China, for example, faced difficulties in sourcing earlier in the year as this country was the first to see significant restrictions imposed. However, even those businesses sourcing locally experienced issues, including the reduced ability to acquire goods due to difficulties in second- and third-tier supply chains.

The political and economic shock of COVID-19 may be felt for years to come, yet the disruption of trade is likely to be relatively short term. Long-term disruptions, such as the geopolitical tensions between the US and China or the future relationship between the UK and the European Union in a post-Brexit world, are going to continue and develop for decades. At present we are already seeing significant impacts on businesses relating to trade disruption. For example, the

US tariffs imposed on goods originating from China and vice versa, the US tariffs imposed on goods originating from Europe, and the tariffs imposed by the EU on products originating in the US drive substantial cost into supply chains and trade flows.

What COVID-19 and these existing trade disputes can remind us is that disruptions can be better understood and managed through a better understanding of your trade data. This can then lead to a better understanding of your global movement of goods and overall supply chain.

Technology and analytics can be used to review your trade data to quickly run through your entire supply chain and identify the flows and products that will be impacted both right now and in the future. This will provide immediate insight into the potential costs that your business will bear but more importantly allow you to plan how to manage these costs. This could be through the implementation of an inward processing or drawback program, for example, or even looking at potential new sourcing options.

With this data analyzed and visualized, the power to manage these trade wars and disruptions is put back into your hands, allowing you to not only see your business through the disruption but also stay ahead or at least abreast of your competitors.

For the UK, this approach has been used to great success by businesses that have been using technology and analytics to prepare for Brexit. Calculating the duty impact is relatively straight forward and something many businesses have reviewed. However, using your intra-EU movements data to identify documentary requirements by commodity code, identify problematic incoterms by supplier, analyze the benefits of certain trade regimes, review master data for discrepancies, and identify data likely needed to be ready for a potential FTA are areas that are best understood through the use of more in-depth analytics.

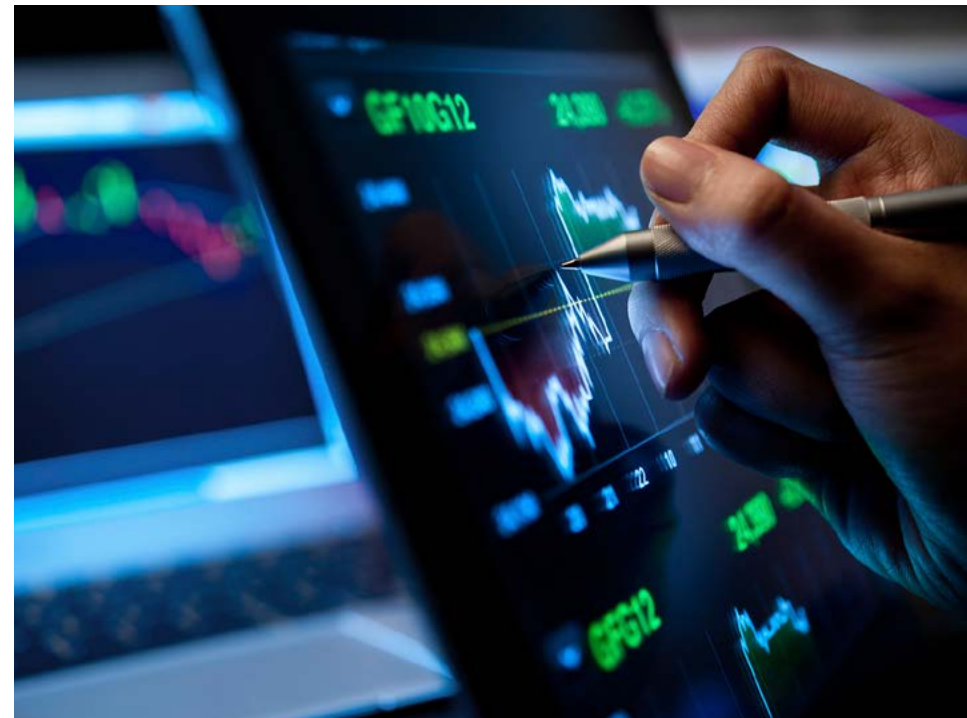
Running data through an analytical model shows exactly where the opportunities really are, and very importantly also: the information can be presented in an easy-to-understand way that can be presented to a finance director or CFO to help them understand the financial benefits on one simple screen, instead of having to go too much into the customs-technical details.

During these challenging times, we are seeing that technology and analytics are used to an even greater degree by businesses to react and manage the pandemic's impact to them. For example, in the UK there is public data published by the government that includes imports into the UK by commodity code, country of origin, value and weight. In addition, separate data allows the public to see what businesses are importing by commodity code. Using this kind of data has allowed businesses to assess where demand is rising or falling and where there are potential new sources of supply.

Further to this data, visualization software can easily show what measures are available around the world that allow for COVID-19-related duty reliefs, allowances and export controls. This allows global businesses to have a better understanding of how they can best manage cashflow, reduce costs and make use of whatever benefits authorities around the world are providing to help businesses manage this challenge.



The key message from all this is simple. COVID-19 is going to fade away eventually but a new pandemic or disruption will happen. Trade disputes will evolve and will not disappear either. Ensuring you are ready for these disruptions will require you to understand your data, your movements and also use external data to better understand the global market. Armed with this information, your business can be ready for the next challenge while seeing through the current one. ■



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The power of technology in global trade: webcast series

EY's UK Global Trade team recently presented a series of five webcasts on *The Power of Technology in Global Trade*. This audio series highlights the complexities that businesses face in dealing with specific customs and trade related topics and outlines possible solutions.

Each session covers current key issues and trends with demonstrations of how innovative trade technology solutions and e data analytics can support agile and cost-effective trade processes that benefit the bottom line.

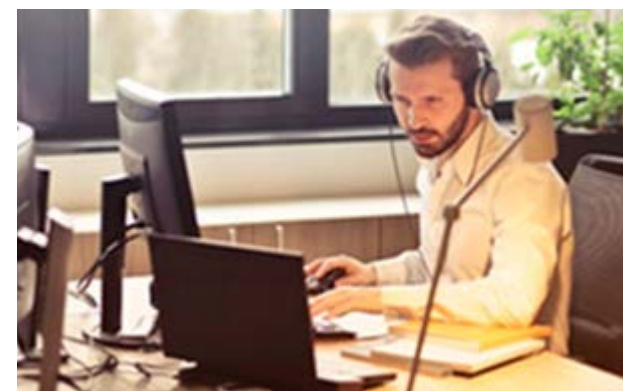
Webcast sessions

- ▶ **The power of technology in Global Trade:** This webcast covered how to use trade data to optimize trade flows, assess compliance risks, identify trade trends, broker performance/accuracy, supply flows, supplier oversight, product classification/value/origin errors and much more
- ▶ **Tariff Classification of products, Analytics and Machine Learning:** Classification is a key, legal requirement for customs declarations. In this webcast, EY Global Trade professionals covered classifications, mainly as a key legal requirement for customs declarations and that they determine not only the duty liability associated with an

imported product but also other tariff and non-tariff measures that apply to the product. It is essential therefore to ensure that they are correct, and we discussed how analytics can assist and simplify the classification compliance process.

- ▶ **Origin and technology services:** This webcast covered origin calculations, evidencing that Rules of Origin are met and how having an effective origin management system will become ever more important for accessing reduced or nil duty rates under Free Trade Agreements (FTAs). This will be particularly important regarding a potential future FTA between the UK and the European Union. Analytics can significantly simplify and speed up this process. This session discussed recent changes in UK, Global FTAs and how analytics could provide solutions going forward.
- ▶ **Trade tensions, scenario modelling and mitigation planning:** This webcast covered how trade disruptions are adding both cost and complexity to many supply chains. It supported in understanding the impact and that options for mitigation will be key for successful businesses going forward. It also examined the recent events in the global arena and discussed how analytics may assist in the analysis and forward planning.

- ▶ **Global Trade Management (GTM) software solutions:** The final webcast in this series discussed the developing use of GTM solutions in the UK today and the range of software available to match different requirements. This may include making your own customs declarations and also managing duty relief schemes (track and trace of goods, etc.). ■



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Certifying Origin: Global trade in a changing world – webcast recording from the EY Global Blockchain Summit 2020



At the EY Global Blockchain Summit 2020 held on 21-23 April 2020, EY showcased an innovative solution for certifying preferential and non-preferential country of origin certifications – **Certifying Origin: Global trade in a changing world.**

This blockchain solution allows importers and exporters to assert the country of origin of goods on a shared, distributed ledger allowing parties in the network can look down the chain of suppliers to collect enough evidence to claim free trade agreement benefits or avoid punitive tariffs.

Certifying Origin: Global trade in a changing world 22 April 2020

[Watch the recording from the Summit](#)

Please visit the [EY Global Summit 2020 website](#) for a list of the sessions including replays and materials.

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COVID-19



How COVID-19 is affecting customs and excise taxes: a trade tracker

This [regularly updated global trade tracker](#) monitors how governments are changing global trade rules in response to the COVID-19 pandemic.

The regularly updated EY COVID-19 Global Trade Considerations tracker helps you monitor rapidly emerging government trade policy responses to COVID-19. Governments around the world are changing trade policies to eliminate import tariffs on COVID-19 critical goods such as personal protective equipment (PPE), ventilators and soap, introducing export restrictions of similar goods, and relaxing regulatory requirements to help business respond quicker and more efficiently.

These changes across the globe are being proposed and implemented on a daily basis. The EY COVID-19 Global Trade Considerations tracker provides a snapshot of what changes have been announced in countries around the world in response to the ongoing crisis.

We've developed additional trackers on key topics to help you monitor the global situation. You can find them on our main Tax page. EY Tax professionals are updating the trackers regularly as the situation continues to develop. ■

How real-time satellite data is keeping supply chains moving

With COVID-19 disrupting global supply chains, EY moved fast to help an advanced manufacturing company maintain the flow of essential goods. Find the article on [ey.com](https://www.ey.com). ■



Global trade webcasts:



How ports and shipping keep goods moving as the world stands still

26 May 2020

In this webcast, panelists discussed the impacts of COVID-19 and looked at how the industry can weather the storm caused by the pandemic.

Join Maritime London and EY trade professionals across the globe as they explored the challenges and risks COVID-19 has created for the ports' ecosystem – and how it's responding.

[Watch the webcast](#)



COVID-19: Beyond headline legal, people and trade stimulus measures

2 June 2020

Approximately US \$20 trillion in stimulus measures have now been announced globally and a growing proportion of corporate leaders are extending their forecasts for the duration of COVID-19-related economic impacts. Businesses are now looking beyond headline stimulus measures and examining the details of all available levers to ensure they are availing themselves of government policies designed to provide relief and support for business during this time.

In this hour-long webcast, EY professionals reflected on insights inherent in a series of new Government Response Trackers posted on ey.com. The panelists from EY Law, People Advisory Services, Trade and Transfer Pricing discussed the actions governments around the globe are taking in response to the COVID-19 crisis and explored how corporate entities around the world are responding.

[Watch the webcast](#)



COVID-19: How global trade finance is being disrupted and redefined

3 June 2020

In this webcast, panelists discussed the impact of COVID-19 on global trade and how banks and corporates are responding.

The impact of COVID-19 on the global economy and global trade is profound. How banks and corporates respond could minimize the fallout on the much needed, and over-burdened supply chain. How banks provide corporate clients with the liquidity and credit they need, while mitigating their own risk, will be essential to consumers and the economy alike. And, how both respond will have short and long-term implications.

The International Trade and Forfeiting Association (ITFA) and EY banking and supply chain professionals explore the challenges and risks facing the banking and corporate sectors.

[Watch the webcast](#)

US: Trade levers in the time of COVID-19

The extraordinary circumstances brought on by the COVID-19 crisis has forced business leaders to navigate the onslaught of unparalleled conditions, ranging from health and safety measures, to supply chain uncertainty, to the impacts of extreme cash flow concerns. The business downturn caused by COVID-19 has further aggravated financial burdens already present from punitive tariffs assessed by the US government on widespread imports.¹ Cash flow is a top business priority as COVID-19 continues to disrupt global supply chain and profitability.

Among the confluence of factors creating uncertainty, there are indeed levers for liquidity available to businesses through customs planning tools. Businesses can take specific trade-related actions to confront some of these financial pressures and to be best positioned for the beyond. A common element for each opportunity is that planning should occur in advance, prior to import, to make sure requirements are satisfied and the positive cash flow benefit materializes.

Structuring transactions with financing for delayed payments

With short- and medium-term cash flow needs key to continuity plans, we see buyers seeking to negotiate longer payment term periods. This can be a stand-alone measure, or in association with a change in incoterms² – i.e., from Free on Board (FOB) (Overseas Port) to Delivered at Place – (DAP-US Port), so as to delay the transfer of title transfer and risk of loss from the overseas port to the US port. However, the seller is not necessarily interested in deferring revenue recognition. One potential solution is to structure a transaction to allow

- ¹ In the United State these include the retaliatory tariffs imposed on: virtually all Chinese origin imports (almost all at 25% additional duties); Section 232 Steel and aluminum tariffs at 25% and 10%, respectively, and tariffs on certain EU origin goods and aircraft.
- ² Incoterms are published by the International Chamber of Commerce for use and consistency in domestic and international shipments. See "Incoterms 2020."

extended terms in connection with the assessment of interest. Under specified conditions, interest payments can be excluded from the declared customs value of imported goods.³ Interest charges are considered non-dutiable where:

1. The charges are identified separately from the price charged for the goods
2. There is a written financing arrangement
3. The interest payments are thusly carried as expenses on the importer's books
4. The buyer can demonstrate the goods are sold at the purchase price without the interest charge
5. The claimed interest rate does not exceed the prevailing rate in the country at the time the financing was arranged

Tax advisors should be consulted as well when considering this option, since interest on a trade payable could trigger withholding tax where the seller is in a country that has no tax treaty with the US, and for consideration of any impact to transfer pricing adjustments, where the interest is payable to a related-party seller.

Securing duty refunds from transfer pricing adjustments

This slowdown likely will produce downward pricing adjustments to US importers purchasing from related parties, similar to what was seen in the 2008-09 downturn. US distributors who are guaranteed a profit margin under transfer pricing principles likely will not have the sales expected to generate those anticipated profits. Therefore, US distributors almost

certainly will receive credits to accommodate for a routine distribution margin. Downward transfer pricing adjustments made to the prices of imported merchandise post-import may entitle an importer to duty refunds for the overpayment of duties (conversely, upward post-importation transfer pricing adjustments may result in additional duties owing for underpayments on previous imports).

Along with the strategic importance of mitigating duty impact, aligning the income tax and customs approaches while ensuring good mechanics are in place for reporting any transfer pricing adjustments to US Customs and Border Protection (CBP) is an important action to take. In many cases, actions need to be taken in advance of importations. CBP has very specific rules for reporting price adjustments, such as transfer pricing adjustments made after importation,⁴ including adding customs specific language to transfer pricing policies.

Adding to the profit pressure is the consideration of any applicable punitive duties. These also complicate the transfer pricing adjustment process when duties are present for only a portion of the year (including, for example, if an exclusion was granted for the goods). Accordingly, in these times especially, importer participation in the CBP reconciliation program is vital (see [Actions for business](#) on the following page).

Optimize the impact of supplier credits/ discounts

Supplier credits and discounts that are structured properly can be excluded from the dutiable customs value of imported goods, resulting in increased cash

flow from duty savings. The reduced purchase price resulting from foreign seller discounts can be used for customs valuation purposes⁵ (i.e., represent transactional value – which is the “price actually paid or payable” for the goods),⁶ where the following conditions are met: (1) the discount or price adjustment is agreed on prior to the importation of the merchandise; (2) the importer can provide CBP with sufficient documentary evidence to support the existence of the discount and establish that it was agreed to before the time of entry; and (3) the discount or price adjustment is unconditional, or if conditional, all the conditions are met prior to importation.⁷ CBP regulations further provide that the price actually paid or payable may be the result of discounts, or negotiations, or may be arrived at by the application of a formula.

Utilize various duty payment deferral options

Businesses that have experienced slower sales as a result of COVID-19 and consequently lower inventory turnovers can utilize Foreign Trade Zones (FTZs) or bonded warehouses to defer duty payment until the goods are withdrawn for sale. Goods can be admitted to an FTZ (physically located within the US

³ See HQL H235895 (August 22, 2014).

⁴ HRL W548314 (May 16, 2012).

⁵ HRL 547019 (March 31, 2000); and HRL 545659 (October 25, 1995).

⁶ 19 U.S.C. 1401a(b)(1); 19 U.S.C. 1401a(b)(4)(A). The price actually paid or payable” is defined as the total payment (whether direct or indirect, and exclusive of any costs, charges, or expenses incurred for transportation and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation in the United States) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller.

⁷ See HRL 545659 (October 25, 1995); *Allied International v. United States*, 16 CIT 545, 795 F. Supp. 449 (1992); HRL 547144 (November 20, 1998); HRL 545659 (October 25, 1995); HRL 546037 (January 31, 1996).

but considered outside the customs territory) and stored there without the payment of duties. Duties are payable only when the goods are withdrawn from the FTZ for use in the US. Duties may be avoided altogether on unsold inventory that is re-exported, or on perishable or seasonal inventory that is destroyed. Bonded warehouses provide similar duty deferral and avoidance benefits.

Outside the use of FTZs and bonded warehouses (which require some advanced planning and an application process), taking advantage of a duty drawback program offers an opportunity for a refund of 99% of the duties paid on imported goods that are re-exported or destroyed. The unused merchandise provision of the duty drawback program allows a refund of duty paid on imported goods when the imported merchandise, or substituted like-kind merchandise, is destroyed or exported without use in the United States. Even past exports may qualify for drawback under certain conditions. There has been noticeable client interest in pursuing these trade mechanisms.

Actions for business

Scenario forecasting

To operate effectively in this ongoing period of trade uncertainty requires companies to manage and plan for tariff optimization strategies powered by the full suite of trade tools with support from enhanced data analytics and systems. US importers have the distinct advantage of having easy access to their import and export data through CBP's ACE (Automated Commercial Environment) secure data portal. Clients are using this data to conduct

scenario modeling and cost-benefit analyses to determine which program provides the most effective solution during the pandemic and sets the business for success after the pandemic. Companies that act quickly on a few opportunities will be better positioned to weather the storm.

Reconciliation

Participation in CBP's reconciliation program is an important action to take to preserve potential duty refunds from transfer pricing and other post import value adjustments. The program allows customs value to be declared at time of importation based on pricing then available, and at importation those declarations (entries) must be flagged for value reconciliation. The importer then has 21 months to reconcile the value to include the pricing adjustment by filing a reconciliation entry. US importers must take appropriate actions to benefit from available refunds through use of the reconciliation program. These require that a customs bond rider be obtained from the company's surety and the importer's customs broker be instructed to start flagging entries for reconciliation at the time of import.

Enable responses to supply restrictions and diversification

Layering in new supply chain resiliency requirements to manage and reduce costs will require integrated supply chain and trade responses. Trade teams need to be prepared to assess the consequences of these alternate sourcing models (i.e., FTA applicability, new supplier qualifications) and to optimize any trade program benefits.

Export restrictions, potential changes to government procurement policies to favor domestic producers and public health-based closures all have forced reconsideration of supply chains with trade implications. Indeed, on 10 April 2020, the US Federal Emergency Management Agency (FEMA) published a temporary rule that requires CBP to detain any export shipment of five types of personal protective equipment (PPE) needed to help combat the COVID-19 crisis⁹ pending explicit FEMA approval. We are helping our client trade teams in the agility they need to support processes for redirecting goods and other back-up procedures to mitigate these unforeseen import/export restrictions.

Prepare for subsequent agency scrutiny

The continued emphasis on supply chain insourcing by the US, along with pressure on public finances, means heightened tax and customs authority attention to transactions should be expected. As well, while the US-China Phase I deal continues to

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- ⁹ These items were designated by the Secretary of Health and Human Services as scarce or threatened.
- N95 Filtering Facepiece Respirators, including devices that are disposable half-face-piece non-powered air-purifying particulate respirators intended for use to cover the nose and mouth of the wearer to help reduce wearer exposure to pathogenic biological airborne particulates
 - Other Filtering Facepiece Respirators (e.g., those designated as N99, N100, R95, R99, R100, or P95, P99, P100), including single-use, disposable half-mask respiratory protective devices that cover the user's airway (nose and mouth) and offer protection from particulate materials at an N95 filtration efficiency level per 42 CFR 84.181
 - Elastomeric, air-purifying respirators and appropriate particulate filters cartridges
 - PPE surgical masks, including masks that cover the user's nose and mouth and provide a physical barrier to fluids and particulate materials
 - PPE gloves or surgical gloves, including those defined at 21 CFR 880.6250 (exam gloves) and 878.4460 (surgical gloves) and such gloves intended for the same purposes

enjoy the Administration's political support, the broader deterioration in US-China economic relations is a continued source of economic uncertainty, so continuing to be prepared for rigorous enforcement is recommended.

Continue mitigation planning as uncertainty of trade policy evolves

The COVID-19 crisis has renewed calls by many business groups for a steep reduction in the US Administration's punitive tariffs on China and terminating the tariffs on imported steel and aluminum. The Administration has refused to consider any rollback of retaliatory duties. Product by product exclusions are available under the US Trade Representative's (USTR) process. To date several hundred exclusions have been granted. USTR is also now offering a prioritized tariff exclusion process for medical-care products needed to address the COVID-19 outbreak, with a focus on personal protective equipment products and other medical-care related products.¹⁰

While focusing on the significant trade challenges presented by the COVID-19 crisis, exacerbated by continued attention to the punitive tariffs, other trade measures also will create a demand for

trade resources. In the near term, that includes the planned July 1, 2020 entry-into-force of the USMCA (creating new and stricter rules of origin requirements for certain sectors like automobiles and auto parts). On the longer-term trajectory, the US and EU continue their discussions with the real possibility of a "mini-deal" being struck covering areas like standards before the US election, while down the road will include the scope of the US-UK FTA negotiations and the UK's trading relationship with the EU.

Conclusion

The business slow down due to COVID-19, plus punitive tariffs has led to unique economic circumstances that have customs impacts. Companies can turn to customs and trade planning levers as effective tools to manage the increased uncertainty from COVID-19 and as part of a cash management strategy.

While forecasts for the pace and rate of economic recovery vary, scenario planning for multiple outcomes will allow companies to execute strategically upon the rebound, whenever it occurs. ■



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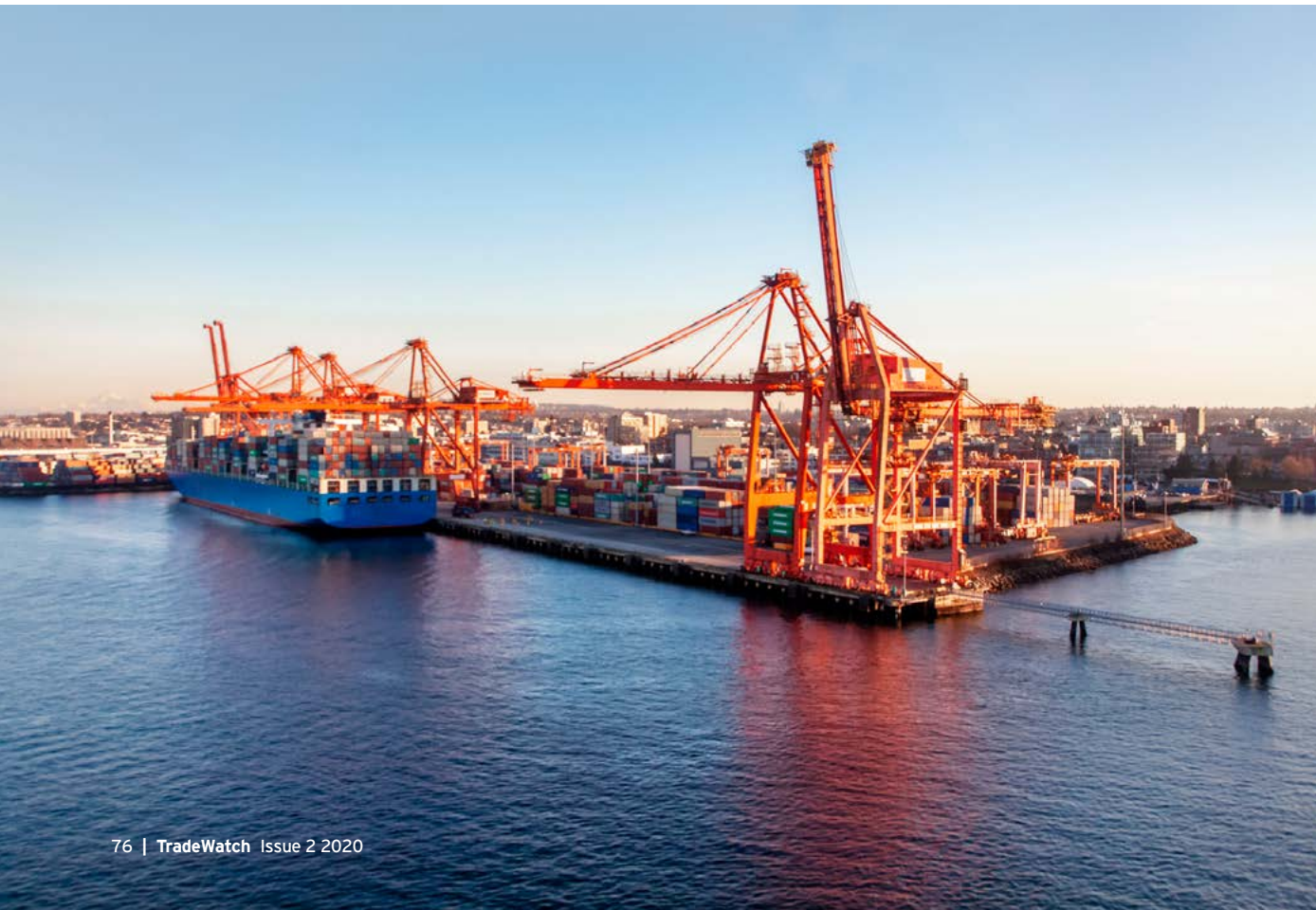
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¹⁰ The covered items include "parts needed for MRI devices, combined PET/CT scanners, certain radiation therapy equipment, air purification equipment, and parts of homecare beds; sterile electrosurgical tools; digital clinical thermometers."

Canada: Why are importers facing challenges in benefiting from the COVID-19 duty and tax deferral measures?



Effective 27 March 2020, under the authority of Section 33.7(1) of the Customs Act, the Canada Border Services Agency (CBSA) extended the payment deadlines of customs duties and import goods and services tax (GST) on regular imports and reassessments to 30 June 2020 for CBSA monthly statements of account (SOA) in March, April and May 2020.¹

No application to CBSA for deferral is required, as the extended payment due date will apply automatically.² However, importers who benefit from release prior to payment (RPP) privilege through their appointed customs broker's bond posted with CBSA will likely need to revise their service agreement with the customs broker to benefit from the payment deferral measure. Current industry trends suggest several importers are encountering difficulties in deferring payment of duties and import GST to CBSA, due to the terms of their service agreements with their appointed customs broker.

Summary of CBSA bulletins and guidance

In response to inquiries from the importing community regarding the deferral measures, CBSA has issued several Accounts Receivable Ledger (ARL) Bulletins to clarify for questions regarding importer eligibility for deferral, interest on amounts owing and

¹ Customs Notice 20-11, Extension of Timeframes for Payment of Customs Duties and GST (COVID-19).

² Accounting timeframes prescribed by the Accounting for Imported Goods and Payment of Duties Regulations remain unchanged.

whether certain transactions with CBSA are subject to different due dates. The subjects addressed in the relevant bulletins (ARL Bulletins 52 to 56)³ are summarized below:

- ▶ Deferred payment of duties and import GST applies to resident and nonresident importers (NRIs).
- ▶ Debt due to corrections filed by importers with CBSA (Form B2 submissions) on or after 25 March 2020 is deferred to 30 June 2020. All B2 debt due before 25 March 2020 is payable on the due date identified on the SOA. In addition, existing appeals not affected by Customs Notice 20-11 are still in effect, and any amounts outstanding must be paid for CBSA to accept a request for re-determination under section 60 of the Customs Act.
- ▶ In the event importers are unable to pay their SOA in full on 30 June 2020, interest may apply. If payment in full has not been received by the deferred payment date of 30 June 2020, interest calculations will be made from 1 July 2020 onward.
- ▶ Related debt owing on the SOAs dated March, April and May 25, 2020 is deferred to 30 June 2020. ARL Bulletin 54 provides a more detailed breakdown of affected and unaffected due dates per transaction type, reproduced here:

Transaction type	Amended due date
B3 A debt transaction on the account that is always related to an importation	All B3s due 1 April to 30 June will be due on 30 June
B2 (debit) A correction/adjustment to a B3 transaction	All B2 debts due 25 March and after will have a due date of 30 June
B2 (credit) A correction to a B3 transaction	Not impacted by this deferral measure and will be processed as normal
K3 or K23 Miscellaneous debt	Original due date remains
A1 or AMPS AMPS is a penalty imposed for violating CBSA's trade and border legislation	Original due date remains
RS (RSF) Posting CSA Program – Self Assessment	All RS transactions due 31 March and after will have a due date of 30 June
K9 Penalty for not declaring a product	Original due date remains
K32 Drawback A refund for custom duties paid for imported goods. In order to get the drawback credit, the importer must file a drawback	Not impacted by this deferral measure and will be processed as normal

Practical challenges of benefiting from payment deferral

Many importers in Canada rely upon the posted security of their customs broker, rather than posting their own security with CBSA for RPP privileges. Under such an arrangement, the customs broker may be liable for remitting duties and import GST owing to CBSA.

Per sections 9 and 10 of the Accounting for Imported Goods and Payment of Duties Regulations (“Regulations”), RPP privilege will be granted if the importer or owner of the goods gives or has given security to CBSA in the form prescribed by section 11 of the Regulations, the most common of which is a bond. When a broker posts a bond with CBSA on behalf on an importer, the terms of the bond establishes the customs broker’s liability for remitting amounts owing to CBSA.

Specifically, when completing a Form D120, Customs Bond, the customs broker is instructed to include a statement, for the purposes of RPP privilege, indicating that the broker must remit all monies “that the principal, as agent for the importer and/or owner has taken to remit on account of duties.”⁴

In short, once a customs broker posts a bond with CBSA, the customs broker effectively acts as an agent for security posted with CBSA to securitize the released goods of its importer principals, but it is the customs broker that is the principal under the bond agreement with the CBSA. Per the Regulations, CBSA is entitled to collect amounts owing against the bond if accounting and payment is not rendered within the prescribed timeframe for RPP privilege.

³ For more details, please see <https://www.cbsa-asfc.gc.ca/prog/arl-glcc/res-eng.html>

⁴ Memorandum D17-1-8, *Release Prior to Payment Privilege*, Appendix B – Instructions for the completion of Form D120, Custom Bond for customs brokers

Even following the issuance of Bulletins 54-56, which signaled clarifications in the statements of account and which clearly specified the due date for payment is 30 June 2020 (and no sooner), customs brokers still consider the risk of bearing the accumulated deferred amounts on their customs bond at and immediately after the due date to be rather significant.

Current service agreements between importers and their appointed customs brokers likely require the importer to remit monies to their customs brokers on a monthly basis, in line with SOAs. In consequence, importers now face a scenario wherein their appointed customs broker insists that SOAs are paid on time rather than having payment deferred, as the customs broker will want to minimize potential exposure if the importer is unable to pay amounts owing to CBSA on 30 June 2020.

For this reason, it is highly recommended that importers initiate discussions to arrive at a solution with their appointed customs broker, as the commercial realities of importing are evolving rapidly and rendering current service arrangements obsolete in the face of new and quickly rising business challenges. Importers can explore the option to post security directly with CBSA, subject to revising their service agreement with their appointment customs broker. By posting security with CBSA directly, the importer can defer payment of amounts owing to CBSA per the deferral measure, and their customs broker will not be required to assume any financial liability for remitting any amounts owing on behalf of the importer.

As the deferral expiry date is rapidly approaching, importers are advised to explore posting a bond with CBSA directly as soon as possible to maximize the cash-flow benefits of the deferral measure. EY teams are currently supporting importers in setting up direct security with CBSA and revising service agreements with customs brokers. ■

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Insights on the impact of COVID-19 trade policies in Asia-Pacific

On 15 May 2020, we asked three EY Global Trade professionals based in Asia-Pacific to share their insights into the impact of COVID-19 on trade policy in the region and what they expect to see in the future. We hear from Adrian Ball, EY ASEAN Global Trade leader, based in Singapore; Paul Smith, EY Oceania Global Trade leader, based in New Zealand; and Yoichi Ohira, EY Asia-Pacific Indirect Tax Leader, based in Japan.



Adrian Ball
EY Asia-Pacific
Global Trade Partner



Paul Smith
EY Oceania
Global Trade leader



Yoichi Ohira
EY Asia-Pacific
Indirect Tax Leader and
Global Trade Leader

EY: What are you seeing in the region with respect to customs and trade policies as a result of COVID-19?

Yoichi Ohira (YO): The first thing I'd say is that different countries across Asia-Pacific are at different stages. China, for example, is starting to come out of the health crisis, and factories are starting to operate again. We are seeing a return to international supply chains operating there, while other countries are still in full lockdown. That has an impact on what is happening in different jurisdictions and the issues that companies and customs authorities are dealing with.

Taking China again as an example, earlier in the crisis, the customs authorities were not contacting importers and were not carrying out audits, but now we are starting to see movements within customs that indicate customs audits will be starting up again in earnest. I think we can expect that trend across the region, as governments first look to help businesses but then will be looking to improve their own financial situations, which have been heavily impacted by the crisis.

Adrian Ball (AB): In ASEAN, we see the tax authorities are facing the same practical difficulties in this situation as businesses are, such as increased absences and staff needing to work from home. That might mean splitting customs teams to allow for social distancing or it might mean a reduction in physical inspections and so on. So many things that were normal before COVID-19 just aren't possible now.

But businesses and authorities are rapidly adapting to the "new normal." For example, customs audits are being carried out again, but they are being done in a different way. Previously, customs auditors may have spent a week or more at a business's premises. Now we see the authorities going on site for only half a day but requesting soft copies of data from the business and using information from different sources. This is one way that COVID-19 has changed customs in the short term, but I think it is also in a way that is likely to be significant going forward. There will continue to be greater emphasis on the importance of data.

Paul Smith (PS): In Oceania we have been in lockdown for eight weeks now – and like in many countries around the world, it's the first time that borders are closed. The first four weeks of lockdown in New Zealand were characterized by an intense period of change, and we have since seen some significant indirect tax measures being introduced.

At the start of the crisis, supply chains were disrupted and broken. This had a knock-on effect to the supply chain of essential goods, and in turn we saw special rules being introduced to keep these goods moving. We also saw the list of such goods gradually expanding.

As we transition into alert level two, it will mean that the economy will start opening up again and trade will improve.

EY: What customs-related stimulus measures are you seeing as a result of COVID-19?

YO: I would say that we have not seen a lot of trade-related stimulus measures from governments in the region. Of course, there are import and export measures for personal protective equipment (PPE) and essential goods directly related to fighting the disease. But we do not generally see many further special measures from a customs perspective, apart from some payment deferral arrangements and the easing of some trade compliance measures. For example, some companies have found it hard to obtain certificates of origin and some authorities have been flexible about what is acceptable.

AB: In ASEAN, apart from easements and duty reductions for vital goods such as PPE, there are few special measures related to trade. Most of the stimulus measures have been economic.

PS: In New Zealand, there has been a deferral of all payments for goods and services tax (GST) and customs duties on imports. Businesses have been getting deferrals for up to six months. This represents a cash injection for the businesses – as you can get a GST input tax deduction for imported goods at the time of importation before you have to pay back the GST amount to customs six months down the line. It's a simple measure, but an important one. Such deferrals have now also been expanded to include excise tax.

EY: What are businesses experiencing in this crisis? And how can EY teams help?

YO: Well, it is clear that the crisis is having a big impact on supply chains and on business resilience. In terms of the needs of our clients, we see that they want to hold on to cash. There are many ways that we can help them to increase efficiency and improve their cashflow and advise them on the disruption they are facing in their supply chains.

PS: Yes, cash is king right now! And that is relevant for all sectors. In this situation, indirect tax is a great place to look for real opportunities, as measures aimed at relieving indirect taxes can generally help businesses much more quickly than measures aimed at alleviating direct taxes. Simple actions can have a big impact. For example, we recently requested a payment deferral for a client and that gave them immediate access to cash.



Particularly in Australia, clients are showing a lot of interest in how customs data analytics can find cash refunds to help the business.

YO: Yes, customs can definitely be a quick way to save cash for the business. We have also been using global trade data analytics to help clients understand their data and see where savings are possible. That has been a trend in Oceania for a while, as you say Paul, but we are now seeing it happening more and more in Japan and in other countries in the region.

I think it's important to stress that these cash savings often do not rely on new measures. Generally, we are looking at tried and trusted ways of reducing customs burdens, for example with valuation, or by using free trade agreements (FTAs), and making sure you have the right compliance in place to support preferential origin and so on.

What is different is how we are now using technology to identify them and our managed service capabilities to support clients' in-house trade functions. For example, often companies know what FTAs are available, but they do not have the resources to manage the rules to use them to the fullest. We can help by doing that on their behalf.

AB: The impact to companies across the ASEAN region varies considerably. If a company is export focused and is already taking advantage of free trade zones and other bonded facilities, then we are hearing the duty impact is not significant. However, where duties are being paid, it can often be because a lot of businesses don't use FTAs to the fullest, so that is a big opportunity. Also, in places like Malaysia, there are exemptions that can be applied for those

that were already in place before COVID-19, but they weren't necessarily being used. So, we are encouraging our clients to consider using these types of reliefs, which can often be obtained and help the business very quickly.

EY: Looking forward, what do you expect to see in the near term?

YO: I believe that the next phase of the customs response will see technology transformation greatly speeding up. Currently, import/export documentation is very paper driven. This means customs analytics can be difficult and time consuming because of the format of the data. Improving the way data is collected, and in what format, will vastly improve customs analytics, not just for businesses but also for the tax authorities.

AB: This crisis will have stressed organizations in all kind of ways – and that disruption may last for some time. China was affected earlier than the rest of the world, and a lot of clients were relying on China to keep their supply chains and goods moving. A lot of factories across the region had to stop production because of the lockdown, and so they could not meet customers' orders. Some companies are still facing operational disruption, from not being able to locate the goods they need, relying on other businesses, and having no or poor data records. The disruption being experienced in different countries and by different companies is coming from the same cause, but with different outcomes.

I agree that technology is going to play a pivotal role. A lot of businesses don't have a customs management system; as such, they rely heavily on their logistic partners for their documentation.

I think that will become an issue. As technology transforms and changes the way we work, having a proper global trade management system will become more important than ever. Embracing that change will help businesses to be more agile, improve cash flow, take advantage of reliefs and work more effectively with a remote workforce.

PS: What you are both saying resonates with me. Looking ahead, I think that businesses will bounce back, but how they operate will change for sure.

In Oceania, we are seeing companies changing their supply chains and their operating models. From a commercial perspective, there is more e-commerce and online shopping, which is putting more pressure on warehouses and freight. We are doing a lot to help companies manage the tax and trade consequences of increasing their online operations.

EY: What do you expect to see from customs and trade measures further down the line?

PS: It has been clear from Australia and New Zealand that businesses rely heavily on international trade flows, and they don't want protectionist measures introduced. It looks like governments in Oceania are listening and are trying to avoid introducing such measures; however, they may look to other indirect taxes. There is already speculation about possible GST rate increases to balance the stimulus spending.

AB: Even before the impact of COVID-19, companies were transforming and de-risking their supply chains. After COVID-19, even more companies will be looking to make their supply chains more resilient, diversifying procurement and production. I don't see ASEAN countries putting up trade barriers,

but protectionist measures of other countries will help accelerate supply chain transformations, with ASEAN countries a major beneficiary.

YO: I think we can also expect to see trade controversy on the rise, especially for the next few years. Governments are going to want to recover as much as they can in tax revenues, to set against the amount of reliefs and refund payments they are offering now.

Under the World Trade Organization rules, countries cannot simply increase customs duty rates. However, jurisdictions could turn to other measures to achieve the same effect. In Asia-Pacific, most countries use FTAs to allow duty free importations when importers meet the rules. In practice, we have found that many businesses are using the reliefs, but sometimes they are not fully compliant, because they misunderstand the rules. Enforcing those FTA rules more strictly is not a change in duty rates, but it is likely to increase duty receipts for governments. Businesses should expect that tax authorities will be increasing their audits in this field, so getting it right and having the correct documentation will take on great significance.

Transfer pricing and customs valuation will be also be more of a focus for customs authorities. In fact, we are already seeing this trend.

PS: In Oceania, the tax authorities have already announced that if you use any of the special measures currently available to businesses, you can expect an audit in the future. So, we would advise our clients to document all processes, to ensure they capture the right data for any future audits and mitigate against the risk of penalties.

AB: Adding to what's already been said, clearly governments will need revenue as a result of the crisis – and indirect taxes will be first on the list. As you say, Yoichi, they can't just increase duty rates. So, they will most likely introduce revenue measures from some of the other usual sources, for example, imposing excise duties on cigarettes and alcohol, etc. Businesses operating in these sectors should definitely be aware of this.

PS: Right now, businesses should try to understand what stimulus measures are available to ease cash flow, and identify what customs opportunities are out there to save cash. Getting to grips with those measures is crucial and can help your business survive. But you should also keep an eye on the future. Governments are trying to help businesses in every way they can – but in the future, companies will be audited on these issues. So, if you take advantage of any relief measures you will need to document your entitlement to the relief measures very carefully. ■

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India: Trade policy scenario in post COVID-19 era

Many countries may consider strengthening their inward-looking trade policies. Measures such as creating a foreign investment-friendly policy environment, focusing on sectors that amongst other objectives, will also substitute India's import needs, may provide India a head-start to revive the economy. ■

[Read the article on ey.com](#)

Italy: Customs measures and opportunities in response to COVID-19

The health emergency due to COVID-19 has had significant social and economic implications worldwide. To contain the spread of this pandemic, starting from 9 March 2020, Italy, like other major world economies, decreed a first phase of lockdown by imposing the closure of many national companies operating in areas of the economy considered to be “nonstrategic”. This led to many businesses suddenly finding themselves facing unprecedented legal concerns and challenges.

Measures taken by the Italian Government

In response to the crisis, the Italian Government launched a series of important measures that had a significant impact on many companies' supply chains.

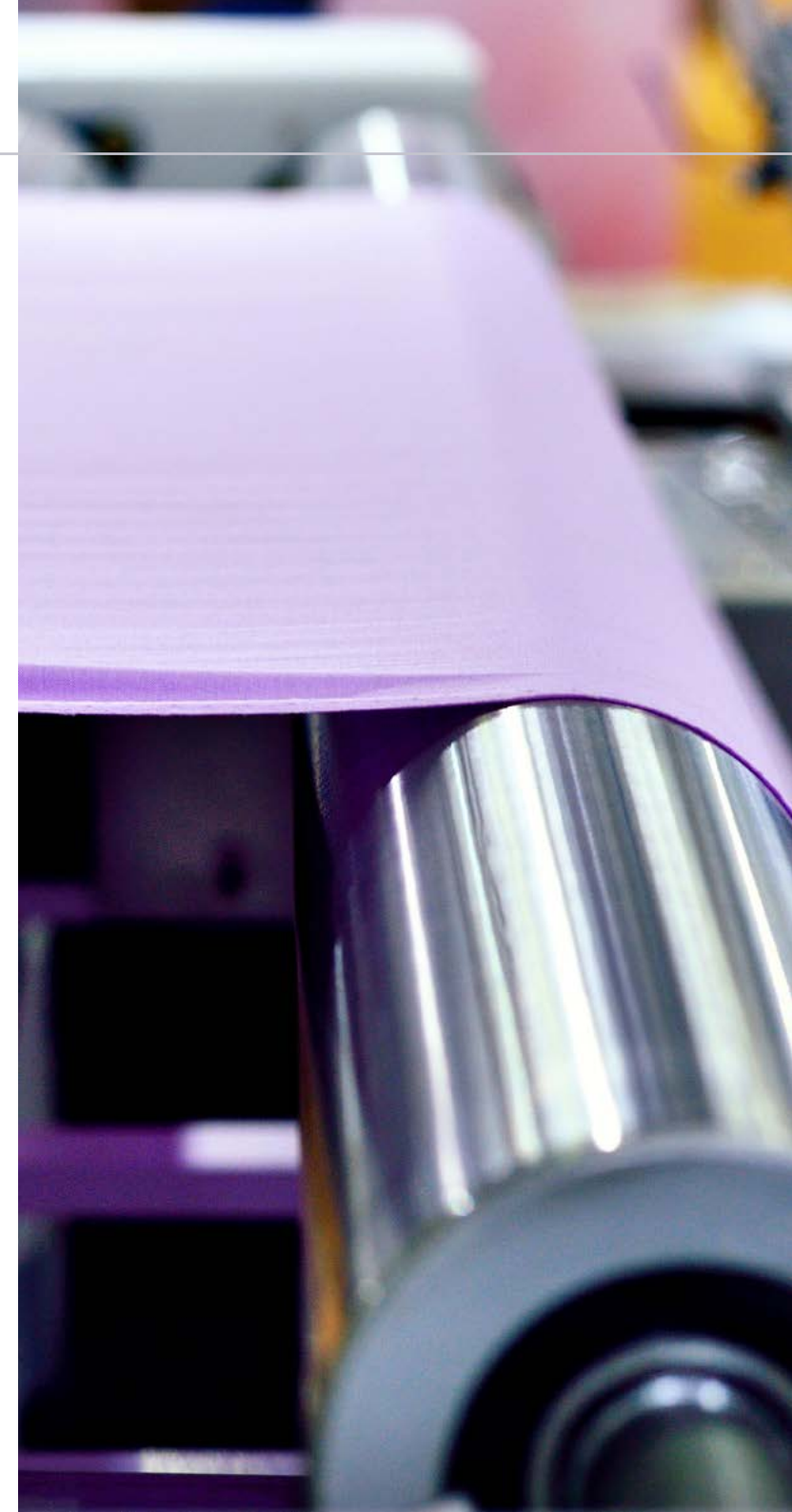
- ▶ **Strategic goods:** Important procedures were activated to facilitate and speed up the import of essential personal protective equipment (PPE) and other medical devices. These included exemption from customs duties and VAT. At the same time, specific authorizations were introduced for exporting these products. To provide the exemption from customs duties, it was necessary to involve the European Union (EU), which issued a specific Regulation aimed at authorizing the non-collection of duties when importing these goods.

- ▶ **Non-strategic sectors:** For all other companies operating in “nonstrategic” sectors, in March and April, the Italian customs authorities decided to suspend the examination, as well as the issuance, of any customs authorizations, and they invited economic operators not to submit applications that were not absolutely necessary, or urgent and that or could therefore be deferred.

Beginning in May 2020, the Italian Government announced the gradual reopening of some activities with the adoption of safety protocols against the risk of workplace infection. These protocols included prevention and protection measures to safeguard the health and security of workers, as well as the environment.

Action for businesses

With the reopening of the national market, it is crucial for companies to address challenges and identify risks that, in the light of COVID-19 health emergency, affect demand for rapid and time-sensitive goods. It will be challenging for companies to create a supply chain that is able to prevent potential shocks to the system, for example, in the procurement of components, intermediate goods and finished products and to deal with the instability of the demand following the significant reduction in consumption, the decline in investment and the



uncertainty of future expectations. Due to these challenges and risks, companies need to clearly define the path to be followed for restarting their business as quickly as possible.

It is therefore essential to develop a strategic plan for reorganization. Companies must first decide whether their business can operate in the same manner as before, prior to the pandemic, or whether there may be opportunities from new market demands as a result of the emergency. For example, the list of companies that converted part of their production to meet the increased demand for PPE and medical devices grows by the day. These products will likely constitute a solid market in the near future. Most of these businesses are companies that currently produce clothing, linen or footwear, which may convert production for longer. Demand is also likely to increase for businesses involved in the production of goods necessary to implement “smart working.”

Global trade and tax considerations for businesses

The next step is to carry out a critical and strategic review of the entire supply chain. Companies can then proceed with custom planning aimed at optimizing business processes, while identifying tax and duty savings and reducing enterprise risk by increasing the level of compliance. Some of the available mechanisms include:

Customs planning activity focused on tax savings, needs to focus on the free trade agreements (FTAs) that the EU has signed with other countries around the world. Technology and data analytics will also

help business to identify special customs procedures, including tariff suspensions, by allowing them to process readily available information quickly.

For example, examining compliance with an FTA's main criteria makes it possible to verify the correct fulfillment of the obligations provided for in the agreement, which is necessary in order to benefit from the payment of a lower customs duty in the beneficiary country. In the event that the conditions are not being complied with to benefit from the FTA, analyzing the data can also make it possible to intervene in the supply chain, as well as in the choice of suppliers to ensure the fulfillment of these criteria. This allows the business to benefit from a lower customs duty payment with the introduction of a few changes.

The use of special customs procedures such as warehousing or inward processing procedures may also allow optimization by generating savings from the nonpayment of customs duties or from postponing or deferring the time of taxation.

At the same time, within the scope of increasing customs compliance, customs planning can facilitate the streamlining of processes that not only reduce organizational and financial burdens but also strengthening the relationship with customs authorities. Specific relevance is given to obtaining authorized economic operator (AEO) authorization. AEO status allowing easier access to all customs procedures and greater control over the supply chain, it also allows for greater fluidity of trade with foreign markets.

In the field of customs valuation, it is necessary to identify criteria for a correct determination and to establish procedures that, in the case of retroactive adjustments such as those resulting from transfer pricing adjustments, allow the contextual modification of the customs value. The use of tools such as binding tariff information (BTI) and binding origin information (BOI) can help provide certainty on the correct classification and origin of goods.

As the Italian economy gradually opens up and lockdown measures are eased, international trade will resume. However, for many companies it will not be business as before. Some will be engaged in new activities, others will be responding to new patterns of trade and altered supply chains. Customs planning will be more important than ever to help them meet their new obligations cost effectively and efficiently. ■

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South Africa: Customs and excise relief measures in the time of COVID-19

On 15 March 2020, the South African President declared a state of national disaster as a result of COVID-19. This was followed by the imposition of a 21-day national lockdown that commenced

on 26 March 2020. Currently, a five-tiered lockdown schedule has been instituted, level five being the most restrictive and level one the least restrictive on citizens and business. As a result

of the unprecedented COVID-19 lockdown, the government also introduced various relief measures to businesses, including tax relief.



Customs and excise relief measures

We consider the customs and excise relief measures below.

Import VAT and duty rebate - critical and essential goods

- ▶ Regulations were enacted to provide VAT and customs relief for critical and essential goods imported into South Africa during the lockdown period. Critical goods are those goods that are imported for the purpose of combating the COVID-19 pandemic, such as medical supplies. These goods are eligible for a full rebate of customs duties, as well as a VAT exemption, subject to an eligibility permit issued by the government.
- ▶ Essential goods are those goods that are not critical in the fight against COVID-19 but are essential in aiding in the relief of the effects of the pandemic during the lockdown period, such as food and hygiene products. These goods are subject to a VAT exemption on importation during the lockdown period.
- ▶ The list of critical and essential goods is not a closed list, and additions are being made as the pandemic progresses and needs change.

Carbon tax – deferral of filing and first payment

- ▶ The Carbon Tax Act came into effect on 1 June 2019. Carbon tax is assessed, collected and enforced as an environmental levy in terms of

the Customs and Excise Act. The government announced a deferral of the filing requirement and the first carbon tax payment, which was due at the end of July 2020. This liability has been delayed by three months and will now only be due on 31 October 2020.

Excise duties and instalment payments

- ▶ Special provision has been made in respect of the payment of excise duties on tobacco products, beer, wine, other fermented beverages and spirits; and other spirituous products. A licensee, who is excise compliant, may defer the payment of these excise duties for 90 days. No penalties for such deferred payment will be levelled against a qualifying licensee in respect of the amount deferred, unless this amount is not paid when it becomes due at the end of the deferral period. The deferral of excise payments came into effect on 1 May 2020.
- ▶ In addition, another relief measure announced was an instalment payment agreement. This simply means that a person liable for an amount to SARS can enter into an agreement with SARS, after obtaining permission, to pay the amount due, in instalments. Certain requirements also need to be met to qualify for this relief, and further supporting documents can be requested by SARS before an agreement will be accepted. Arrangements for the instalment payment agreement can be made with SARS since 7 May 2020.

Looking ahead

- ▶ The South African government has made it clear that the country's peak COVID-19 infection rates are still expected over the next few months, especially given that winter is approaching. Currently the country is in a level four lockdown, and the five-tier lockdown schedule will continue to be implemented over the next few months.
- ▶ The customs and excise relief measures have been welcomed and are aimed at assisting business with cash flow at the moment. The only certainty at the moment is that the situation remains highly fluid, and as South Africa moves between the various levels of lockdown, business can expect more changes in customs and excise measures to occur. ■

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Tax Alerts

A dark gray world map outline is centered in the background of the slide. The map shows the continents of North America, South America, Europe, Africa, Asia, and Australia. The text 'Tax Alerts' is overlaid on the map in a large, white, sans-serif font.

Tax Alerts

Americas

Brazil

- ▶ New Ordinance published by Sao Paulo State Authorities establishes new procedures for importing goods within state and brings cash flow opportunities (06.04.2020)
- ▶ Brazil's Superior Court of Justice extends tax benefit to sales of goods destined to the Manaus Free Trade Zone (25.03.2020)

Canada

- ▶ US publishes Interim Implementation Instructions and Alternative Staging Regime for auto industry; Prepares for 1 July USMCA Entry into Force (27.04.2020)
- ▶ Canada ratifies trade agreement with US and Mexico (17.03.2020)
- ▶ Yukon issues budget 2020/21 (06.03.2020)
- ▶ Alberta issues budget 2020-21 (28.02.2020)
- ▶ Northwest Territories issues budget 2020-21 (27.02.2020)
- ▶ Nova Scotia issues budget 2020-21 (26.02.2020)
- ▶ British Columbia issues budget 2020-21 (20.02.2020)
- ▶ Canada again begins Canada-US-Mexico Agreement (CUSMA) ratification (05.02.2020)

Costa Rica

- ▶ Costa Rica's Ministry of Foreign Trade requests comments on draft authorized exporter regulations (20.04.2020)
- ▶ General Directorate of Customs updates Customs Procedures Manual (05.03.2020)

Dominican Republic

- ▶ Dominican Republic's Executive Branch enacts voluntary disclosure program and tax amnesty (24.02.2020)

Mexico

- ▶ Baja California's Congress approves new tax legislation, including an emissions tax (11.05.2020)
- ▶ US publishes Interim Implementation Instructions and Alternative Staging Regime for auto industry; Prepares for 1 July USMCA Entry into Force (27.04.2020)
- ▶ Canada ratifies trade agreement with US and Mexico (17.03.2020)
- ▶ Canada again begins Canada-US-Mexico Agreement (CUSMA) ratification (05.02.2020)

OECD

- ▶ OECD releases consultation document on model rules for data reporting by platform operators for sellers in the sharing economy (27.02.2020)
- ▶ OECD hosts webcast on preliminary impact assessment and economic analysis of BEPS 2.0 project proposals (21.02.2020)

OECD (continued)

- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)

US

- ▶ USTR publishes USMCA Uniform Regulations Chapters as trade prepares for 1 July Entry into Force (11.06.2020)
- ▶ USTR initiates investigations into digital services taxes either adopted, or under consideration, by certain jurisdictions (05.06.2020)
- ▶ US Treasury and IRS announce that references to NAFTA in US income tax treaties should be interpreted as references to USMCA (26.05.2020)
- ▶ US Bureau of Industry and Security tightens export controls on China, Russia and Venezuela with new rules on military end users and removal of a civilian license exception (04.05.2020)
- ▶ US publishes Interim Implementation Instructions and Alternative Staging Regime for auto industry; Prepares for 1 July USMCA Entry into Force (27.04.2020)
- ▶ US issues additional Section 301 exclusions, China continues to provide retaliatory tariff relief, and WTO Appellate Body Alternative is reached (31.03.2020)

US (continued)

- ▶ Canada ratifies trade agreement with US and Mexico (17.03.2020)
- ▶ US Government imposes stricter export restrictions on Russia and Yemen (25.02.2020)
- ▶ Oregon: Portland clean energy surcharge, as well as other taxes, may apply to real estate industry (20.02.2020)
- ▶ Ohio Supreme Court holds receipts earned by intrastate transportation of gas are subject to public utility excise tax (18.02.2020)
- ▶ US Customs and Border Protection issues guidance on treatment of List 4A merchandise held in FTZs; USTR grants new exclusions and issues amendments for Chinese-origin goods as well as report on WTO Appellate Body concerns (18.02.2020)
- ▶ US Trade Representative announces new tariffs on EU-origin goods (18.02.2020)
- ▶ Canada again begins Canada-US-Mexico Agreement (CUSMA) ratification (05.02.2020)
- ▶ Venezuela
- ▶ US Bureau of Industry and Security tightens export controls on China, Russia and Venezuela with new rules on military end users and removal of a civilian license exception (04.05.2020)

Asia-Pacific

China

- ▶ US Bureau of Industry and Security tightens export controls on China, Russia and Venezuela with new rules on military end users and removal of a civilian license exception (04.05.2020)
- ▶ US issues additional Section 301 exclusions, China continues to provide retaliatory tariff relief, and WTO Appellate Body Alternative is reached (31.03.2020)
- ▶ US Customs and Border Protection issues guidance on treatment of List 4A merchandise held in FTZs; USTR grants new exclusions and issues amendments for Chinese-origin goods as well as report on WTO Appellate Body concerns (18.02.2020)
- ▶ Turkey restricts importation of certain animal and agricultural products from China into free trade zones (14.02.2020)
- ▶ China adjusts certain 2020 commodity import tariff rates (06.02.2020)

OECD

- ▶ OECD releases consultation document on model rules for data reporting by platform operators for sellers in the sharing economy (27.02.2020)
- ▶ OECD hosts webcast on preliminary impact assessment and economic analysis of BEPS 2.0 project proposals (21.02.2020)
- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)

Europe, Middle East, India and Africa

EU

- ▶ Turkey notifies WTO on measures against EU-origin goods (02.06.2020)
- ▶ Brexit: Business considerations to prepare for UK exit and trade between the UK and EU (29.05.2020)
- ▶ US Trade Representative announces new tariffs on EU-origin goods (18.02.2020)
- ▶ European Commission publishes 2020 Work Programme, including two tax initiatives (31.01.2020)

France

- ▶ France postpones implementation of EU definition of exporter to 1 October 2020 (20.04.2020)
- ▶ **Ghana**
- ▶ Ghana amends Customs Act to provide incentives for the automobile industry (02.06.2020)
- ▶ Ghana enacts various tax amendments (03.02.2020)

Kenya

- ▶ Kenya proposes Finance Bill, 2020 (08.05.2020)

Namibia

- ▶ Namibia issues 2020 Budget (29.05.2020)

OECD

- ▶ OECD releases consultation document on model rules for data reporting by platform operators for sellers in the sharing economy (27.02.2020)
- ▶ OECD hosts webcast on preliminary impact assessment and economic analysis of BEPS 2.0 project proposals (21.02.2020)
- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)

Russia

- ▶ US Bureau of Industry and Security tightens export controls on China, Russia and Venezuela with new rules on military end users and removal of a civilian license exception (04.05.2020)
- ▶ US Government imposes stricter export restrictions on Russia and Yemen (25.02.2020)

Rwanda

- ▶ Rwanda grants tax amnesty until 30 June 2020 (05.03.2020)

Turkey

- ▶ Turkey notifies WTO on measures against EU-origin goods (02.06.2020)
- ▶ Turkey introduces new Additional Customs Duties, temporarily amends certain current duties (23.03.2020)
- ▶ Turkey restricts importation of certain animal and agricultural products from China into free trade zones (14.02.2020)

Saudi Arabia

- ▶ Saudi Arabia increases customs duty rates on imports (01.06.2020)
- ▶ Saudi Customs launches self-correction program for import transactions (18.02.2020)

South Africa

- ▶ South Africa's Minister of Finance delivers 2020 Budget Review (28.02.2020)

UK

- ▶ UK publishes new Global Tariff (21.05.2020)
- ▶ Brexit: Business considerations to prepare for UK exit and trade between the UK and EU (29.05.2020)
- ▶ UK Budget – March 2020 (12.03.2020)
- ▶ UK customs and VAT treatment of imports and exports after Brexit transitional period (13.02.2020)

United Arab Emirates

- ▶ Dubai Customs announces changes in proof of origin requirements (25.03.2020)

Yemen

- ▶ US Government imposes stricter export restrictions on Russia and Yemen (25.02.2020)

Tax Alerts: COVID-19



COVID-19: Americas

Canada

- ▶ Canada provides relief on imports of certain medical goods (COVID-19) (11.04.2020)
- ▶ Economic Response Plan: Additional tax administration measures and extensions announced (23.04.2020)
- ▶ Canada announces deferral of customs duties and import GST payments (31.03.2020)
- ▶ Canada Revenue Agency announces additional filing deadline extensions (30.03.2020)
- ▶ Global trade: WCO, Canada and US updates on COVID-19 actions (30.03.2020)
- ▶ Ontario announces action plan (26.03.2020)
- ▶ Ontario action plan – COVID-19 (25.03.2020)
- ▶ British Columbia announces relief plan (25.03.2020)

Columbia

- ▶ Colombia issues additional COVID-19 tax measures during second state of emergency (12.06.2020)
- ▶ Colombia issues COVID-19 tax measures (25.03.2020)

Costa Rica

- ▶ Costa Rica's Ministry of Public Health publishes resolution on temporary importation of certain products without registration (30.03.2020)
- ▶ Costa Rican Government enacts law to mitigate tax and economic impact of COVID-19 (26.03.2020)
- ▶ Costa Rica's General Directorate of Customs publishes directive to control export and re-export of medical supplies (20.03.2020)

Guatemala

- ▶ Guatemala enacts Emergency Law to Protect Guatemalans from the Effects Caused by the COVID-19 Pandemic (02.04.2020)

Mexico

- ▶ Mexico proposes amending miscellaneous tax regulations to suspend certain due dates in response to COVID-19 (06.05.2020)

Panama

- ▶ Panama's National Customs Authority establishes temporary procedure for importation of certain goods for humanitarian aid due to COVID-19 (01.04.2020)

Puerto Rico

- ▶ Treasury Department announces additional extensions for various returns and payments and provides special cash flow tax relief measures because of COVID-19 (30.03.2020)

Uruguay

- ▶ Uruguay's Executive Power issues decree authorizing tax-free importation of certain medical supplies (30.04.2020)

US

- ▶ US announces limited policy for 90-day deferral of payment on certain imports due to COVID-19 hardships (20.04.2020)
- ▶ State and local tax agency responses to the COVID-19 pandemic continue (03.04.2020)
- ▶ Global trade: WCO, Canada and US updates on COVID-19 actions (30.03.2020)
- ▶ US extends deadline for payment of duties and taxes, provides guidance on ruling requests and issues a statement regarding COVID-19 (23.03.2020)

World Customs Organization

- ▶ Global trade: WCO, Canada and US updates on COVID-19 actions (30.03.2020)

COVID-19: Asia-Pacific

Korea

- ▶ Customs and Excise considerations related to COVID-19 (06.05.2020)

Philippines

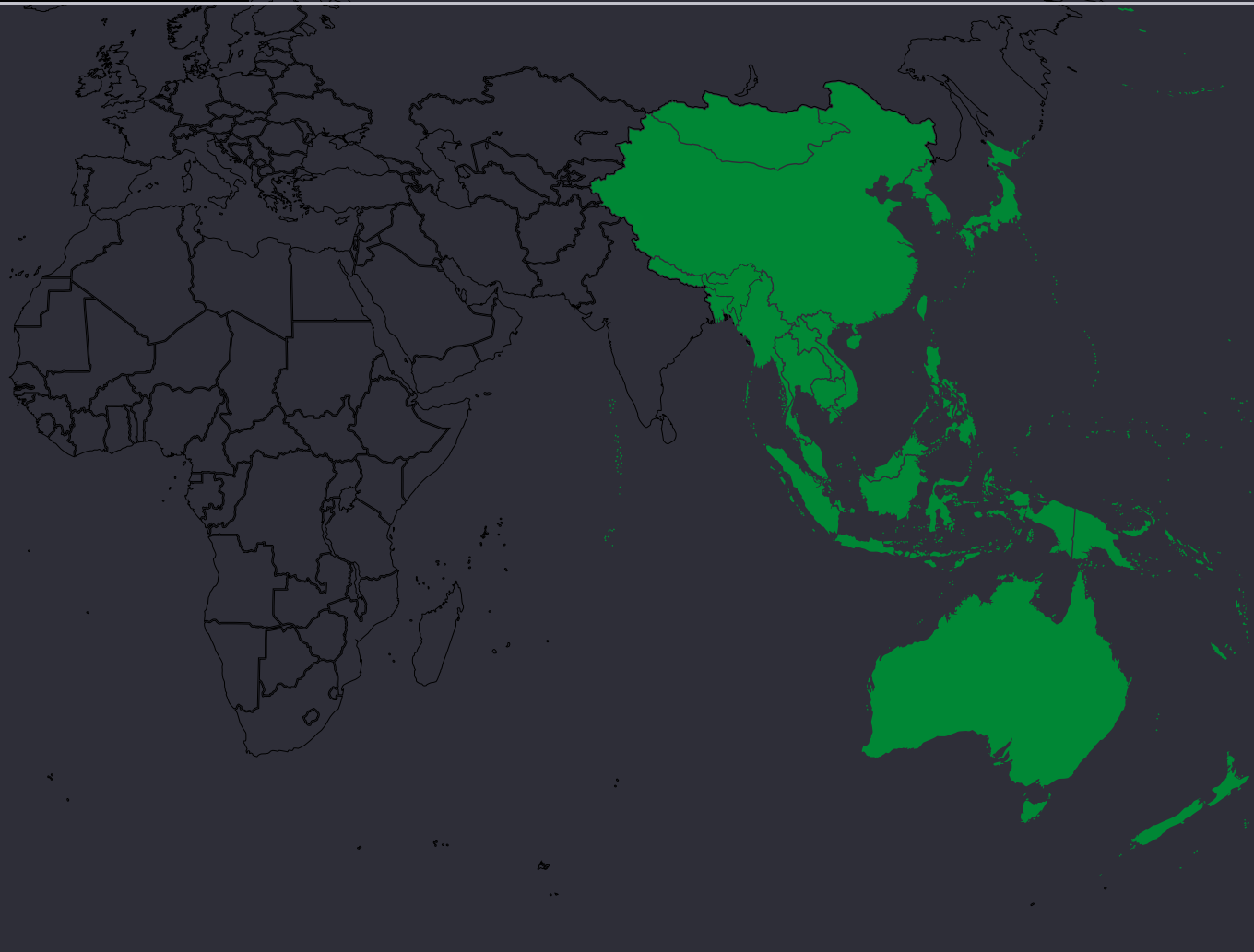
- ▶ Philippines grants incentives to importers and local manufacturers of "Critical Health Equipment and Supplies" (21.04.2020)

Thailand

- ▶ Thailand announces additional excise and customs duty related measures to support businesses during COVID-19 and duty exemption to encourage investment (27.04.2020)

World Customs Organization

- ▶ Global trade: WCO, Canada and US updates on COVID-19 actions (30.03.2020)



COVID-19: Europe, Middle East, India and Africa

Czech Republic

- ▶ Draft amendment to the Excise Duties Act in connection with COVID-19 (22.04.2020)

EU

- ▶ European Commission publishes proposal for recovery plan and adjusts 2020 Work Programme (28.05.2020)

France

- ▶ France postpones implementation of EU definition of exporter to 1 October 2020 (20.04.2020)

Germany

- ▶ German Government announces additional stimulus package in response to COVID-19 (20.04.2020)

Italy

- ▶ Italy enacts "Relaunch Decree" to further manage COVID-19 (05.06.2020)

Jordan

- ▶ Jordan announces economic measures to reduce the impact of COVID-19 (18.03.2020)

Mauritius

- ▶ Mauritius enacts legislation to mitigate impact of COVID-19 (21.05.2020)

Mozambique

- ▶ Mozambique introduces tax and customs measures to mitigate COVID-19 impact (30.04.2020)

Netherlands

- ▶ Dutch Government extends and expands emergency measures in response to COVID-19 (28.05.2020)
- ▶ Dutch Government updates tax and legislative measures in response to COVID-19 (01.04.2020)

Norway

- ▶ Norway proposes Revised Fiscal Budget 2020 (14.05.2020)
- ▶ Norway takes additional measures in connection with COVID-19 (02.04.2020)

Portugal

- ▶ Portugal introduces indirect tax stimulus measures, including VAT changes, in response to COVID-19 (20.04.2020)

Romania

- ▶ Customs, excise and green tax obligations: How to efficiently treat them in the context of COVID-19 crisis? (25.03.2020)

South Africa

- ▶ South Africa announces VAT exemption and Customs Duty rebate on importation of essential goods (08.04.2020)
- ▶ South Africa: Tax relief measures in response to COVID-19 (03.04.2020)

UK

- ▶ Medical equipment easements announced on UK import VAT and duty (02.04.2020)

Uzbekistan

- ▶ Uzbekistan introduces tax measures to support the economy and business in response to COVID-19 (26.03.2020)

World Customs Organization

- ▶ Global trade: WCO, Canada and US updates on COVID-19 actions (30.03.2020)

Zambia

- ▶ Zambia issues additional fiscal measures to mitigate the impact of COVID-19 (24.04.2020)
- ▶ Zambia introduces fiscal measures to mitigate impact of COVID-19 (02.04.2020)

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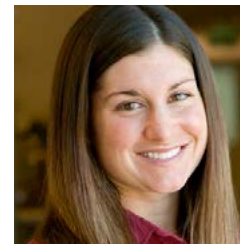
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