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EU: European Commission publishes draft legislation for binding valuation information

On 21 December 2022, the European Commission published a proposal for the introduction of decisions relating to binding information in the field of customs valuation.[1] The introduction of such a decision would give legal certainty to EU importers about their customs valuations. The aim is for the legislation to apply with effect from 1 December 2025.

Customs valuation

The customs value of imported goods is one of the three elements used to determine the customs debt. In complex supply chains, determining the customs value can create challenges for the importer and might result in discussions with the local customs authorities. The discussions relate, for example, to which price elements should be considered for determining the customs value, how to determine the customs value in a series of sales, and how it should be determined in the case of intercompany transactions.

Binding information for tariff, origin and customs valuation

Since 1991 and 1996 respectively, market operators in the EU can apply for binding information decisions on tariff (BTI) and on origin (BOI) to get legal certainty about the applicable tariff classification or origin for goods imported

1 "Binding valuation information (BVI) decisions – inclusion in EU legislation and simplifications to customs formalities," *European Commission website*, 21 December 2022. Find it here

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into the EU. Although Article 35 of the Union Customs Code (UCC)[2] already provides room to also issue decisions for other taxable elements (such as the customs value of imported goods), customs authorities in the EU have refused to issue such decisions, as delegated and implementing provisions were lacking.

After rounds of consultation, on 21 December 2022 the European Commission published proposals for delegated and implementing provisions regarding decisions relating to binding information in the field of customs valuation. The aim of the European Commission is to setup "a transparent and formal process whereby exporters and importers can apply and obtain in advance, from the customs authorities, binding decisions on the customs treatment to be given to imported or exported goods."

How would the binding valuation information (BVI) work?

Most of the general provisions applicable to the BTI and BOI will equally apply to the BVI. The BVI will be binding on its holder as well as on the customs authorities, which means that the customs valuation position agreed upon for a specific case cannot be challenged retroactively. The BVI will also be valid in all EU Member States. It can only be applied for if the applicant has the intention of using it for a customs procedure and it has not yet requested a BVI at the same or another customs office.

Like BTI and BOI, the BVI will be valid for three years from the date when the decision takes effect, and it will not cease to be valid with retroactive effect (unless incorrect information has been provided to the customs authorities).

EU-established traders should apply for a BVI to the competent customs authority in the Member State where the applicant is established or to the customs authority of the Member State in which the BVI decision is going to be used. If a trader is not considered to be established in the EU, a trader should address its application for a BVI to the competent authorities in the EU Member State where it obtained its Economic Operators Registration and Identification (EORI) number or where it intends to use the decision.

2 "Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast)," 9 October 2013. Find it here

Issues to be clarified

The advantage of a BVI is that the customs valuation position agreed upon for a specific set of circumstances, and in the case of imports, made under the same set of circumstances, cannot be challenged. However, one possible challenge with this aspect is that a BVI decision will relate to only one set of circumstances. Up until now, it is not clear what exactly that aspect will entail. For instance, it is not clear if it will be possible to come to a decision about the duty applicable to a royalty payment and whether that decision will still be valid if the royalty agreement is renewed. It is also unclear whether the decision would also be valid with regard to a royalty agreement that is identical to the one that is part of the set of circumstances covered by the BVI with the only difference being that it is concluded with another party.

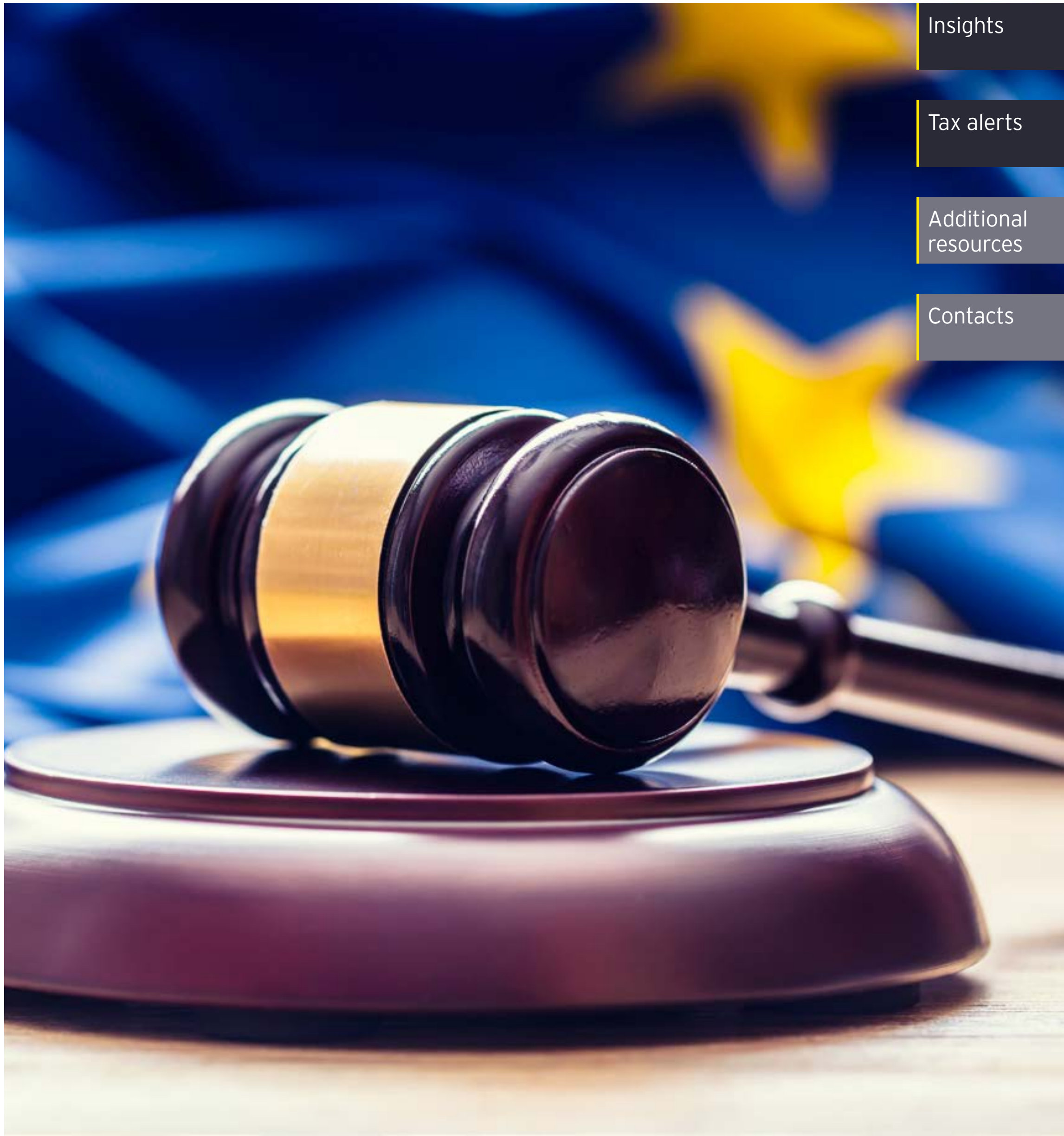
The material scope of a BVI decision seems to be broad. The proposed Article 18a Implementing Act of the UCC states that the decision shall relate to "providing the appropriate method of customs valuation or criteria, and the application thereof, to be used for determining the customs value of goods under particular circumstances." As Article 70(3)(d) of the UCC provides for the condition that the price paid or payable under the transaction value method may not be influenced by the relationship between related parties, it seems possible to also come to arrangements on how customs values should be determined if a buyer and seller are considered related parties. EU guidance on the interplay between customs valuation and transfer pricing is lacking, and EU Member States are currently taking different positions on this issue, especially about if and how transfer pricing adjustment should be taken into account. Therefore, it is currently questionable what such arrangements will look like in practice.

Finally, it is not yet clear how the simplification of Article 73 of the UCC relates to the BVI. Based on this provision, the customs authorities may, upon application, already authorize that the price paid or payable and price elements enumerated in Articles 72 and 73 (e.g., royalty payments, assists, transport costs) are being determined on the basis of specific criteria, where they are not quantifiable on the date on which the customs declaration is accepted. The BVI, on the other hand, seems to have a broader application and provides legal certainty about the appropriate method of customs valuation or criteria, and the application thereof, to be used for determining the customs value of goods under particular circumstances. The scope of the simplification of Article 73 is thus different from the BVI. For example, it is not certain that non-EU established traders can apply for this simplification. On the other hand, based on an unpublished internal agreement between the Member States, the simplification of Article 73 can be applied throughout the EU. In the EU Trader Portal, an option is included to apply for inclusion of more than one Member State of import in the license.

Apart from the differences between the Article 73 simplification and the BVI, in certain cases it might be possible to achieve a similar arrangement under a BVI decision and under Article 73 simplification. Currently it is not yet clear whether the trader is at liberty to choose whether they would apply for BVI or simplification or whether preference is given to one or the other. As the BVI and simplification are subject to different conditions, this potential issue needs to be clarified.

Next steps

As of 18 January 2023, the consultation window on the draft legislation is closed. The BVI is planned to apply from 1 December 2025. However, this date may be postponed depending on the electronic system needed for applications and decisions relating to binding information being live. ■



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EU: Russia sanctions pose challenges for companies

Since the war in Ukraine started in February 2022, the EU has enacted nine sanctions packages against Russia. One of the key elements of these sanctions is that the EU has imposed a number of import and export restrictions on Russia. Entities established in the EU are prohibited from selling or exporting certain products to Russia, and Russian entities are not allowed to sell or export specific products to the EU. Related services are often not permitted either.

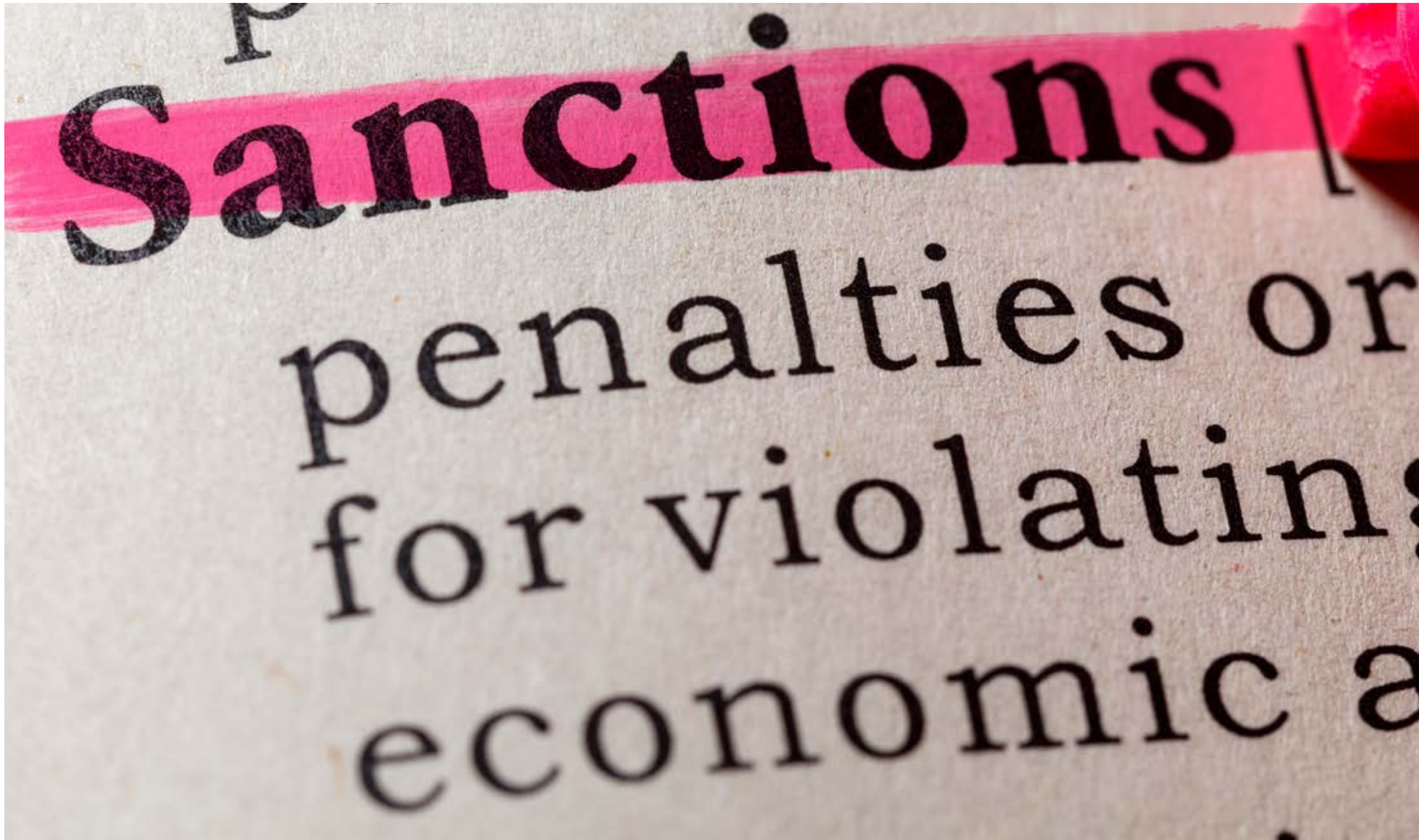
Although, the EU has not enacted a total embargo against any country, the EU sanctions imposed in connection with the war in Ukraine are unprecedented as far as the extent, scope and length of time in effect. Therefore, it is not surprising that companies face challenges in export controls and sanctions to an extent not witnessed before. The main compliance challenges companies face compared with previous trade with Russia are summarized below.

Capacity and workload

The restrictions on trade with Russia now consist of over a dozen lists of restricted items. Each shipment must be checked if the items, business partners or end use are covered by the restrictions. Such transactional screening is now even required for businesses that were previously not affected by sanctions (e.g., food, life sciences, fashion). Companies with good management of material master data have advantages in coping with these checks. Along with responsibilities for new training measures, additional trade license applications and involvement in Russia-related taskforces within the company (e.g., for coordinating the business withdrawal from Russia), this increases workload and stretches the capacity of trade compliance functions.

Complexity of regulations

Within the different packages of sanctions, new instruments have been introduced that have not been a feature of previous sanctions regimes. Moreover, a number of the legal terms being used are not self-explanatory and require further interpretation. Although, the EU Commission has



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provided a detailed FAQ document on the Russia sanctions, the document is not always clear. Some of the terms used (e.g., "deemed export," "facilitation") have their origin in US export controls and sanctions regimes, and they are not commonly used in EU export controls and sanctions, so they may be less commonly understood.

The concept of sanctions "evasion" and "circumvention" also remains unclear. Some Member States are legally not allowed to base penalties on such grounds, as their national courts have decided that it must be sufficiently clear for businesses up front which activities are restricted and which are allowed. Adding to the complexity, on some aspects of the sanctions, the guidance given by the EU Commission and the authorities of individual Member States differs (e.g., if ownership of different sanctioned shareholders has to be added in order to determine whether a non-designated company is subject to the sanctions). Due to the workload of national authorities, clarification of issues cannot always occur in a timely manner and obtaining official export licenses can be a lengthy procedure.

Design of organization and processes

In light of the current environment and frequent regulatory changes, many EU businesses are considering how best to organize their trade compliance function and where it would fit best in their organizations to manage these challenges. Some companies have their trade compliance function located in their indirect tax or customs department, while others opt for the legal and compliance or supply chain function. A one-size-fits-all solution does not exist, and companies have to weigh the pros and cons according to their situation.

Outsourcing of operational tasks (e.g., sanction list screening and classification) is one measure companies are taking to manage their workload in the area of trade compliance. A strategic decision to make is the level of sanctions expertise to be built in-house or whether to work with a third party.

Processes also need to be redesigned as export control authorities expect heightened compliance procedures for transactions with embargoed destinations. As many more businesses and transactions are affected by sanctions regimes than before, the necessity for automation of transactional checks has increased, especially for companies with large volumes of transactions. Additional compliance processes can be required to reduce the risk that indirect business triggers a sanctions violation (e.g., if direct business partners transfer goods to sanctioned destinations).

For group companies located outside the EU, group-wide compliance standards need to be defined, as an EU nexus can be sufficient to trigger the applicability of EU sanctions even outside the EU territory. Moreover, reputational aspects of failing to comply with sanctions regimes also need to be considered.

Importance of business partner due diligence

While it is comparatively easy to check whether a business partner is designated on a sanctions list, it becomes much more complicated to determine whether it is owned or controlled by sanctioned shareholders. In light of more Russia-related designations and the nexus of certain designated individuals to numerous businesses, business partner due diligence has become much more essential to reduce the risk of inadvertent sanctions violations. A combination of manual processes and automated screening can be seen in practice, as sanctions designations are not static; they change frequently. Moreover, in the case of a positive sanctions match, the legal consequences can differ depending on the circumstances, and an individual assessment is required.

Flow of funds and transport

While some banks have stopped the flow of payments to and from Russia altogether, the flow of funds for non-sanctioned business with Russia has generally become more complicated. To reduce compliance risks, banks are asking their customers for extensive information and documentation for Russia-related payments. This leads to increased costs and efforts for companies to fulfill these compliance requirements.

The same can be observed for transport and shipments to and from Russia after Russian transport operators have been banned from entering the EU.

IT services

Due to restrictions on encryption software and hardware (including mass market products) and related services as well as contractual restrictions placed by third-party IT service providers, it has become a challenge to maintain the IT systems of Russian subsidiaries. This can harm the cybersecurity for a whole group of companies.

With respect to IT consulting services, the scope of the restrictions remains unclear. While the legal text of the EU regulation covers, inter alia, software implementation services, the EU Commission's FAQs refer to an outdated United Nations (UN) document from 1991 that covers IT maintenance services for existing services as well. At the same time, the more current version of the UN document from 2015 clearly distinguishes between IT operational support and IT consulting. This leaves companies confused about the legally binding scope and extent of the restrictions. This issue can be complex even for companies in the process of withdrawing from Russia, as these often require some sort of transitional agreements for the Russian business to become a stand-alone entity. Risks for local management due to contrary Russian legislation or local court decisions do not help to solve these issues for companies either, as the risks originating from two conflicting jurisdictions need to be assessed, and individual solutions must be found.

Other business-related restrictions concern the areas of legal advice, architecture and engineering services, accounting, auditing, bookkeeping and tax consulting services, business and management consulting, and public relations services. Additionally, market research and public opinion polling services, technical testing and analysis services, and advertising are also restricted activities.

Conclusion

The sanctions imposed on Russia due to the war in Ukraine have put trade compliance functions into the spotlight within companies, and their importance for ensuring compliance and operability has greatly increased. At the same time, trade compliance functions are stretched to their limits, triggering the need for automation and outsourcing of operational tasks. ■

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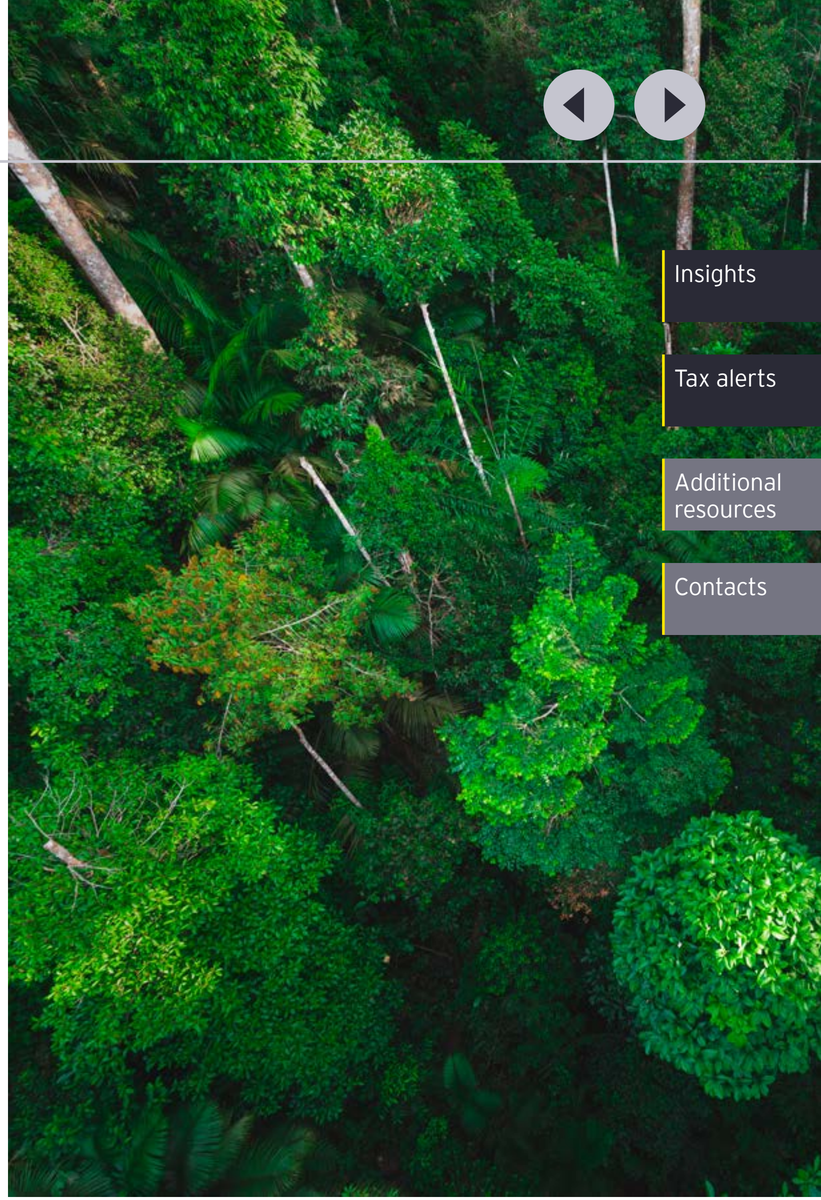

EU: Updated CBAM regulation published

An updated draft of the Carbon Border Adjustment Mechanism (CBAM) regulation was published on 25 January 2023.[1] The new wording reflects the version adopted after three-way discussions of the lawmaking EU stakeholders.[2]

Background

With the European Green Deal, the European Commission set out a new growth strategy aiming to transform the EU into a fair and prosperous society, where there are no net emissions of greenhouse gases (GHG) by 2050. To pursue this ambitious policy, a regulatory framework covering almost every sector has been put in place, starting with the EU Fit for 55 program. The package includes interlinked initiatives covering climate, the environment, energy, transport, industry, agriculture and sustainable finance. Some measures are designed to have extraterritorial effect outside the EU, such as CBAM and the EU deforestation regulation. Others regulate the design of products qualified for marketing in the EU Economic Area, which impacts non-EU exporters and will reshape the EU's framework of development incentives provided to developing and least-developed countries.

A brief overview of the CBAM

The CBAM is an EU climate policy measure addressing the risk of "carbon leakage."[3] This term refers to the risk that industries will shift the manufacture of their products from the EU, which has carbon pricing, to markets with lower or no carbon pricing policies. The measure intends to ensure that the equivalent carbon pricing applies on imported goods compared to the domestic (EU) products that are subject to carbon pricing under the EU Emissions Trading System (EU ETS). Under the original proposal, which has now been superseded, the CBAM was to apply to the following product categories:

- Fertilizers (comprising pre-products)
- Cement (e.g., including clinkers)
- Iron and steel (including various downstream products)
- Aluminum (including various downstream products)
- Electrical energy

1 "Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism (CBAM) – Compromise text," *Council of the European Union website*, 14 December 2022. Find it here

2 The three parties were the European Commission, the Council of the European Union and the European Parliament.

3 Further background information on CBAM can be found in our articles "EU: Final legislation on CBAM expected soon," *TradeWatch*, Issue 2, 2022, page 57, *EY website* – Find it here and "CBAM and its impact on EU cross-border imports," *TradeWatch*, Issue 1, 2022, page 61, *EY website* – Find it here

How the CBAM will operate

The CBAM will closely reflect EU ETS prices and will apply through the use of CBAM certificates to be purchased by EU importers (the customs declarants). The certificates will be priced at the weekly average prices set at the EU ETS auctions.

Under the CBAM, declarants will be required to report annually the total verified GHG emissions embedded in goods they have imported in a calendar year. In addition, during the calendar year, the importer must ensure at the end of each quarter that the number of CBAM certificates on its account in the CBAM registry corresponds to at least 80% of the embedded emissions in imported products since the beginning of the calendar year. Then, along with the submission of the annual CBAM declaration, the declarant will declare and surrender CBAM certificates in the exact number corresponding to the emissions embedded in the goods it has imported in the calendar year.

The exact dates for the implementation of the transitional provisions are subject to final discussion at a political level. The most recent communication suggests a transitional phase for the introduction from 1 October 2023 through 31 December 2025. During this phase, the declarants will have to report embedded emissions in goods imported by way of a quarterly report, detailing direct and indirect emissions as well as any carbon price effectively paid in a third country, but no payments through CBAM certificates will be required.

What has changed since the initial proposal?

Following the three-way discussion on CBAM, which concluded in December 2022, the parties agreed to some significant changes to the regime, but the general principles of the CBAM remain unchanged.

The key changes, compared to the initial CBAM proposal, are:

- An extension of CBAM product scope
- The transitional period starting 1 October 2023, instead of 1 January 2023
- An extension of scope of embedded emissions
- The introduction of exceptions of certain imports from CBAM coverage
- More detailed rules on the application for an authorization to import CBAM-covered goods
- An extended list of circumvention practices

These key changes are detailed below:

Extension of the CBAM product scope

The latest draft of the CBAM regulation includes the following extended scope of products:

- Kaolin and other kaolinic clays, calcined
- Aluminous cement
- Certain ferroalloys
- Agglomerated iron ores and concentrates
- Screws, bolts, nuts, coach screws, screw hooks, rivets, cotters, cotter pins, washers (including spring washers) and similar articles of iron and steel
- Other articles of iron or steel (e.g., metal jackets, metal casters, pipe clamps)
- Aluminum structures and parts of structures
- Certain aluminum reservoirs, tanks, vats and containers
- Stranded wire, cables, plaited bands and the like of aluminum, not electrically insulated
- Other articles of aluminum (e.g., nuts, connectors, washers)
- Hydrogen

The list of covered products will extend in multiple phases over the coming years. The EU Parliament reiterated the goal that all product categories covered under the EU ETS shall be integrated into the CBAM regulations until 2030.

Transitional period beginning 1 October 2023, instead of 1 January 2023

The transitional period is now planned to start on 1 October 2023 instead of 1 January 2023 and is expected to last until 31 December 2025. During this time, the obligations for importers of the products covered will be limited to the reporting requirements, without any financial impact.

Extension of scope of embedded emissions

The definition of embedded emissions has been extended to include indirect emissions occurring in the context of electric energy as well as heating and cooling used in the production of the imported goods. This means that, after the transitional period, when the financial impacts of CBAM will take effect, importers will have to purchase CBAM certificates reflecting both direct and indirect embedded emissions. However, there will be an exception for certain iron and steel products that are subject to measures compensating for indirect emission costs incurred from emission costs passed on in electricity prices in the EU.

Exceptions of certain imports from CBAM coverage

Similar to general customs duties, the CBAM requirements will not apply to:

- Imported goods for which the value does not exceed, per consignment, EUR150
- Goods contained in the personal luggage of travelers from a third country, provided that the intrinsic value of such goods does not exceed EUR150
- Goods to be moved or used in the context of military activities

More detailed rules on application for an authorization

The more detailed rules foresee that prior to importing CBAM goods, importers established in an EU Member State must apply for "authorized CBAM declarant" status. If an importer uses the customs indirect representation scheme, the application for this status must be submitted by the importer's indirect customs representative. The same provision will apply for importers not established in an EU Member State, i.e., the application will be submitted by the non-EU importer's indirect customs representative.

The rules regarding application for authorization will enter into force as of 31 December 2024.

Extended list of circumvention practices

The examples given of circumvention practices (i.e., measures to avoid applying the CBAM) have been slightly extended. The examples are now an open catalog of practices, which may consist of, but are not limited to:

- Slight modification of goods to change their Combined Nomenclature classification
- Artificial splitting of shipments to benefit from the CBAM exceptions described above

Getting ready for the CBAM

In general, the CBAM will affect EU importers through new administrative burdens and costs related to emissions embedded in imported products. As the CBAM quarterly reporting obligation will commence on 1 October 2023, businesses should begin preparation for complying with the CBAM now. We suggest considering the following key steps:

Assess exposure from import and product portfolio

We anticipate that many businesses in the manufacturing and retail sectors will be subject to CBAM formalities, even if the main business purpose of the company does not appear at first glance to relate to products covered by the CBAM. That is because many businesses import widely used products (e.g., metal items) that are within the scope of CBAM. Consequently, the first step for all businesses is an analysis of the portfolio of imported products and suppliers as well as of the entities that will be impacted.

In carrying out such an exposure assessment, potential extensions of the scope of the CBAM should be also considered, such as the possible addition of mineral oil products; organic and inorganic chemicals; polymers (plastics); and eventually glass, ceramics, and paper and pulp.

Review data, processes and responsibilities

Our experience shows that making a business ready for this type of reporting may take several months or even longer. Tasks typically involve a significant review of data availability and processes, such as building a suitable organizational response structure. It is crucial to get these aspects right: even during the transitional period (when CBAM charges will not apply), a penalty may be imposed on a declarant who fails to submit the quarterly report or has not taken necessary steps to file correct CBAM reports. The exact penalties have not yet been specified, but it has been indicated that they shall be "effective, proportionate and dissuasive."[4]

4 Article 26 sec. 2 of the draft CBAM regulation, 14 December 2022. Read it here

Apply to become an "authorized declarant"

After setting up the structure to report under the CBAM regime, it will be important to review, design and prepare the structure for the application phase of the "CBAM authorized declarant" requirement, which is planned to take effect on 1 January 2025. For some corporations, this could mean reorganizing their import transactions, their supply chains and even their operating models – considerations that can lead to fundamental changes and are likely to require time to implement.

Consider strategic impacts

Once the general CBAM impact for a business is understood and a financial impact assessment has been undertaken that shows the future expected cost burden for the business, the strategic impacts should be considered.

Strategic impacts can lead to discussions and activities, including:

- Supply chain analysis and planning
- GHG footprint determination along the supply chain
- Financing and funding evaluation to support realization of measures to reduce GHG emissions (or support other environmental KPIs)
- New contractual setups with supplies and customers
- Preparation of the corporate structure and ecosystem to optimize CBAM payments by use of special customs procedures (inward processing, outward processing, customs warehouse and transit procedures, etc.)

Who else will be impacted?

Non-EU producers may be impacted by CBAM compliance burdens if they voluntarily decide to engage with the regime, such as if they measure their CO^2 emissions in accordance with the EU regulations, have them verified by qualified independent parties and share the information with EU importers for the purposes of calculating the actual embedded emissions.

In fact, all non-EU businesses for which the EU is an important market will be impacted. For example, a non-EU business may have its own operations in the EU so that the matters described above need to be taken care of. But even if a business has no EU presence and is just selling to EU customers, various issues should be considered, such as the impact of CBAM on its competitiveness and decisions about who should bear any new costs.

Finally, even if there are no EU touch points for a business, the topic may still be relevant. CBAM-like border adjustment mechanisms may be established in an increasing number of other jurisdictions. For example, early discussions on a political level have started in the UK and Switzerland, and similar measures have been promulgated in Japan.

Businesses should start their CBAM journey with a comprehensive assessment about what CBAM means to their circumstances – and what it means for their stakeholders. From there, a company can prioritize the different actions it may need or want to undertake, evaluate dependencies, and explore different opportunities to find the best path to approach this new challenge.

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Kingdom of Saudi Arabia: Clearance within two hours initiative

The Zakat, Tax and Customs Authority (ZATCA) has launched a "clearance within two hours" initiative at all entry borders in the Kingdom of Saudi Arabia (KSA). The announcement[1] was made on 26 January 2023, coinciding with International Customs Day.

The ZATCA has made all the necessary preparations to expand the application of the clearance initiative in collaboration with 26 government agencies. Through continuous cooperation with the clearing authorities and related agencies, the ZATCA had already achieved a tangible decrease in the customs clearance cycle time, as indicated below.[2]

2017	2019	2023
Average 12 days	**Average three days**	**Average two hours**

Main objectives

The ZATCA is expanding the implementation of the initiative with the aim of further advancing the efforts of the customs clearance system to facilitate cross-border trade in line with the goals of the country's Vision 2030[3] to become a global platform for logistics services.

The initiative focuses on the following objectives, which cover the effectiveness of the customs ports and their positive outcome on the economy:

- Increasing the flexibility of customs processes to promote a friendly, customs-oriented ecosystem by establishing streamlined links between all the authorities and agencies engaged in import compliance activities
- Increasing the growth of the economy by facilitating cross-border trade and promoting foreign investments
- Improving the quality and accessibility of public governmental services provided to businesses and individuals
- Raising performance and productivity indicators across all customs ports
- Enhancing cooperation with the aim of facilitating customs clearance processes with all local, national and international public and private entities

1 "ZATCA implements 'Clearance within Two Hours' at Customs Ports," *KSA tax authority website*, 22 January 2023. **Find it here**

2 "Time to import, border compliance (hours) – Saudi Arabia," *The World Bank website*. 22 January 2023 **Find it here**

3 "Vision 2030 – Kingdom of Saudi Arabia, *Saudi Arabia government website*. 22 January 2023. **Find it here**

Achieving the right balance between promoting trade facilitation and implementing effective customs controls

With initiatives such as clearance within two hours, international trade in KSA has achieved significant progress as regards customs controls, based increasingly on post-clearance audit and IT-enhanced risk assessment. This gives rise to a fundamental requirement and challenge for national customs authorities – to simultaneously have oversight of physical supply chains for security purposes while pivoting their more traditional revenue controls away from port-based examinations and assessment.

As a result, there is a gradual shift from compliance being the responsibility of the customs authority at the border to being the importer's obligation. We are seeing an increase in the ZATCA's focus on post-clearance audits facilitated using advanced data analytics and artificial intelligence to help the authority identify potential importers to audit. The decrease in clearance cycle time at the border is also impacting the frequency of post-clearance audits to ensure importers have satisfied their customs regulatory obligations and to help maintain the balance between trade facilitation and compliance.

Some of the key international trade instruments at the disposal of customs administrators can help to strike a balance between trade security and trade facilitation, such as the Authorized Economic Operator (AEO) program (referred to as the Priority Program in KSA), which promotes more risk-oriented customs controls. The aim of the program is to support improved trade facilitation, stimulate national economic growth and encourage investment. Through the AEO certification, the customs authority deem the importer to be compliant, and therefore their customs risk is low.

The ever-changing global trade landscape and continuous disruptions render programs such as the AEO and other similar trade facilitation measures crucial for supply chain sustainability both in terms of cost and time.

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UK: Customs valuation policy shift – Method 1 under threat for multinationals

On 3 November 2022, the UK customs authority, His Majesty's Revenue & Customs (HMRC) replaced its long-standing guidance on customs valuation (Notice 252) with a series of new guidance publications on the topic.[1]

The newly published guidance remains substantially the same as that previously published within Notice 252, but there has been a shift in HMRC's policy regarding the interaction between customs valuation and transfer pricing. This may have a significant impact on many UK importers that have related-party import transactions and may also cause them to consider its addition to growing global risk trends.

Related-party customs valuation

The customs value of imported goods is, in addition to the goods classification and origin, one of the three elements used to determine the customs duty due on the importation of goods.

The customs value is determined by applying one of six valuation methodologies that must be considered and applied in hierarchical order (except for Methods 4 and 5). The first method that must be considered and applied, if appropriate, is Method 1, also known as the transaction value. This is based on the price paid or payable for the imported goods when sold for export to the UK.

Method 1 is the default method of valuation and applies to the vast majority of imports. Only where it is not possible to value goods under this methodology is it permissible to consider the next valuation methodology.

There are restrictions placed on the use of Method 1. One such restriction is where the buyer and seller of the goods are related parties, unless it can be demonstrated that the relationship between the parties has not affected the price charged for the goods.

1 "Working out the customs value of your imported goods," *UK tax authority website*, 3 November 2022. Find it here

HMRC policy shift

Multinational corporations that import goods into the UK as part of a related-party transaction have typically applied a Method 1 customs valuation and have relied on their transfer pricing policy documentation to evidence that the relationship between the parties has not affected the price.

Historically, HMRC has been content with this approach and has generally accepted independent transfer pricing studies as sufficient evidence to demonstrate the correct application of Method 1 for these imports. However, with the withdrawal of Notice 252 and the publication of HMRC's new customs valuation guidance, there has been a significant shift in HMRC's stated policy in this regard.

HMRC's new customs valuation guidance states:

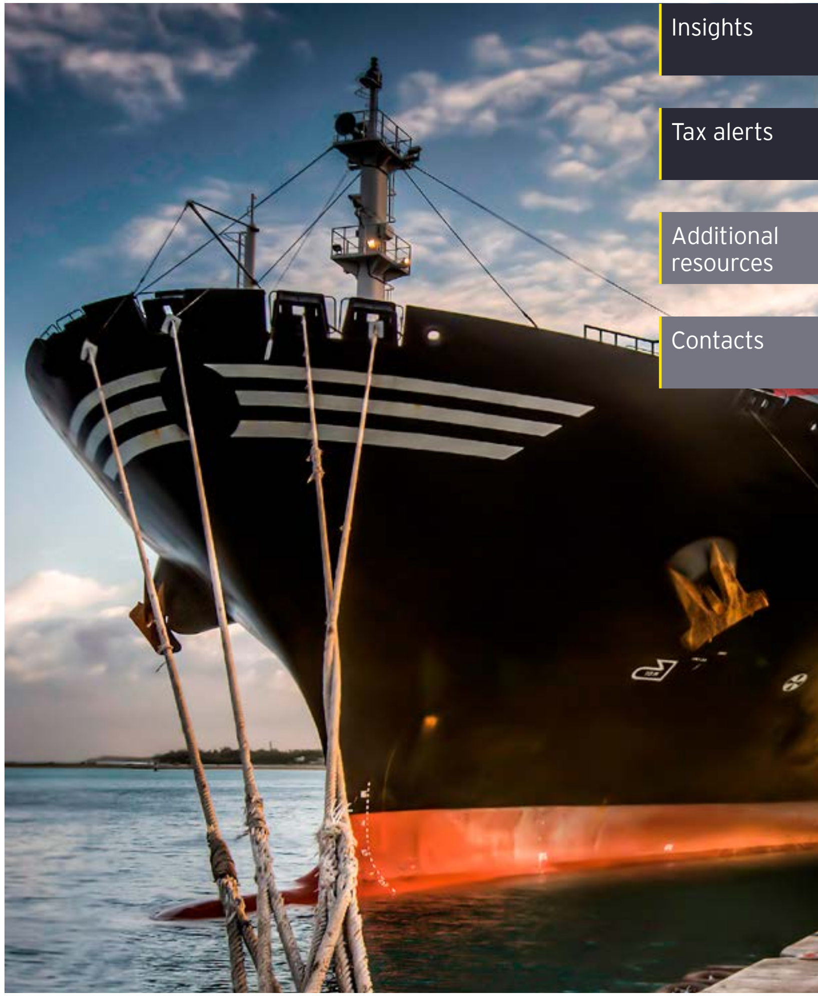
- When considering if a transfer price meets the requirements of Method 1, multinational enterprises must justify their basis of value under customs valuation law. They cannot rely solely on their transfer pricing methodology. They must start with the World Trade Organization framework and the corresponding UK or EU customs valuation law.

  This means that you will not usually be able to use Method 1 with a margin-based transfer pricing model. This is because the real economic value for the imported goods cannot be assured at the time when they are sold for export to the UK. This would also lead to uncertainty with any later adjustments.[2]

HMRC does not elaborate in the guidance on why the economic value of goods cannot be assured under a margin-based transfer pricing model. This is surprising, as transfer prices are required to be set in accordance with the Transfer Pricing Guidelines of the Organisation for Economic Co-operation and Development (OECD)[3] precisely to ensure that related parties trade on an arm's-length basis, i.e., at comparable prices that would be charged between unrelated parties.

This apparent shift in policy also stands in stark contrast to that adopted by the World Customs Organization (WCO), whose technical committee on customs valuation has published various instruments that detail how transfer pricing studies can provide a valuable source of information in establishing whether a relationship between the buyer and seller has influenced the transaction price, even where a margin-based transfer pricing model has been employed.[4]

The reference within the updated guidance and the specific paragraphs under consideration here to "the real economic value for the imported goods" suggests that this shift in policy may be, at least in part, influenced by the judgment issued by the Court of Justice of the European Union (CJEU) on 20 December 2017 in the case of Hamamatsu Photonics Deutschland GmbH (Hamamatsu).[5,6]



2 "Valuing imported goods using Method 1 (transaction value)," *UK tax authority website*, 3 November 2022. Find it here

3 "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022," *OECD website*, 20 January 2022. Find it here

4 We refer, for instance, to 'Case Study 14.1 Use of transfer pricing documentation when examining related party transactions under Article 1.2 (a) of the Agreement' (Adopted, 42th Session, 22 April 2016, VT0920E1c), 1 March 2023. Find it here

5 CJEU 20 December 2017, C-529/16 (Hamamatsu), ECLI:EU: C:2017:984.

6 This case is discussed in detail in our articles "Hamamatsu – a long journey about to end?," *TradeWatch*, Issue 3, 2022, page 63, *EY website*. Find it here, and "EU: CJEU rules on use of statistical data for determination of customs value," *TradeWatch*, Issue 2, 2022, page 35, *EY website*. Find it here

The Hamamatsu case

In the Hamamatsu case, the CJEU stated that the customs value should reflect the real economic value of the goods at the time they are imported; it is not permitted for the customs value to be based on a transaction value consisting of an amount initially invoiced and a flat-rate adjustment made after the end of the accounting period, without it being possible to know whether that adjustment will increase or decrease. The Court consequently ruled that the transaction value method should be rejected and an alternative method should be used for customs valuation purposes.

The judgment in the Hamamatsu case is potentially problematic for a number of reasons. The legislation considered by the CJEU in this case was the Community Customs Code (CCC), which was superseded in the EU by the Union Customs Code (UCC), which in turn has been superseded in the UK by, inter alia, the Taxation (Cross-border Trade) Act 2018 and The Customs (Import Duty) (EU Exit) Regulations 2018.

It has also been widely acknowledged that the judgment in the Hamamatsu case is ambiguous and can be interpreted in multiple ways. As a result, some EU Member States have determined that the judgment is specific to the individual circumstances of the case and cannot be applied more widely.

Already feeling the effects

Despite the apparent ambiguity in the rationale behind this shift in policy, we are already aware of several live cases where HMRC has challenged and rejected the use of Method 1 customs valuation in conjunction with a margin-based transfer pricing model, and we expect to see these types of challenges increase going forward.

Having a valuation methodology, and subsequently the values previously determined under that methodology, rejected by HMRC can lead to significant disruption and uncertainty for businesses as to the correct valuation methodology to employ. Moreover, the historic and future duty position and the ongoing compliance burdens for the importer all become unclear and potentially subject to protracted dispute with HMRC.

All businesses that currently import goods using a Method 1 customs valuation in conjunction with a margin-based transfer pricing model need to be aware of this shift in HMRC policy, and they should start planning for a potential challenge now. This is particularly true for those businesses that make year-end adjustments to the cost of goods sold under their transfer pricing models, as many of these customs valuation challenges by HMRC have been triggered when the adjustment to the cost of goods sold has been declared to HMRC.

Actions for businesses

This HMRC policy shift aligns with challenges to the use of Method 1 in certain other jurisdictions. Therefore, those businesses that have relied on using their transfer prices as the basis for their customs valuations increasingly need to assess the robustness of their valuation method and act proactively.

- **Gather the facts**

  Whether focused solely on the UK or whether looking further afield, the starting point for businesses is collating the facts from their own perspective. This includes getting an understanding of the company's transfer pricing policies, pricing adjustments, valuation controversy history, effective duty rates, etc., broken down by geography.

- **Map the risks**

  The information above can then be risk-mapped against insights about the external customs environment on this topic in each geography, including the topicality of the issue, the availability of rulings, and the local audit and penalty risks (for both customs and value-added tax (VAT)).

- **Design the strategy**

  Once the business's valuation profile is understood, including risk quantification where possible, it is then possible to develop a centralized approach to managing potential risks.

  In designing the strategy, it is essential to be aware that transfer pricing documentation does not automatically defend the use of the transfer price as the basis for customs valuation. Even with government tax and duty departments increasingly working together, and despite the WCO's stance that transfer pricing policies can be useful in determining appropriate customs valuations, it is still necessary to translate transfer pricing policies into WCO valuation criteria.

- **Create a customs valuation defense file**

  This translation exercise can form the core of a customs valuation defense file explicitly supporting the use of Method 1. Combined with valuation profiling (outlined above), it can then direct local action; for example, in high-risk jurisdictions, businesses may produce a specific localized version of the file, or where available, it can be used to support formal customs rulings, such as those that HMRC plans to introduce later in 2023.

- **Improve cross-functional collaboration**

  The activities above can help manage the current state, but the medium-term solution is likely to be in collaboration beyond customs. This is where the valuation profiling exercise can be used to secure the participation of other stakeholders by communicating qualitative and quantitative current state risks.

  The highest priority for businesses, outside of customs, is to drive better operational transfer pricing (OTP) processes that look beyond solely direct tax outcomes. For example, improving OTP outcomes can happen through automation, alternative cost allocation mechanisms and improved audit trails. Consequently, heads of OTP should incorporate the benefits of managing customs and VAT outcomes when evaluating strategic OTP decisions and technology solutions.

  Nevertheless, with direct tax commonly being a higher priority in an organization than customs, and if having exhausted ways to keep them together, businesses may simply conclude that the two disciplines are irreconcilable given the facts, and so they may want to consider explicitly decoupling their transfer prices and customs valuations in selected markets, i.e., opting to use an alternative to Method 1 for imports into those markets.

  While it is still rare for companies to take this action, and it may sometimes even be viewed as a drastic measure, we are seeing this approach being taken more often and seeing positive outcomes in terms of companies reducing their risks, process costs and even direct duty costs as a result.

A realistic timeline

In recent years, the link between associated company transfer prices and customs valuations for imported goods has come to the fore in many parts of the world. In this context, the HMRC policy shift adds further force to the global direction and thus the pressure for companies to act. Disputes with authorities cost money, and disrupted shipments mean lost sales. For any companies that want to make progress on this issue by financial year-end 2023, realistically it means starting now.

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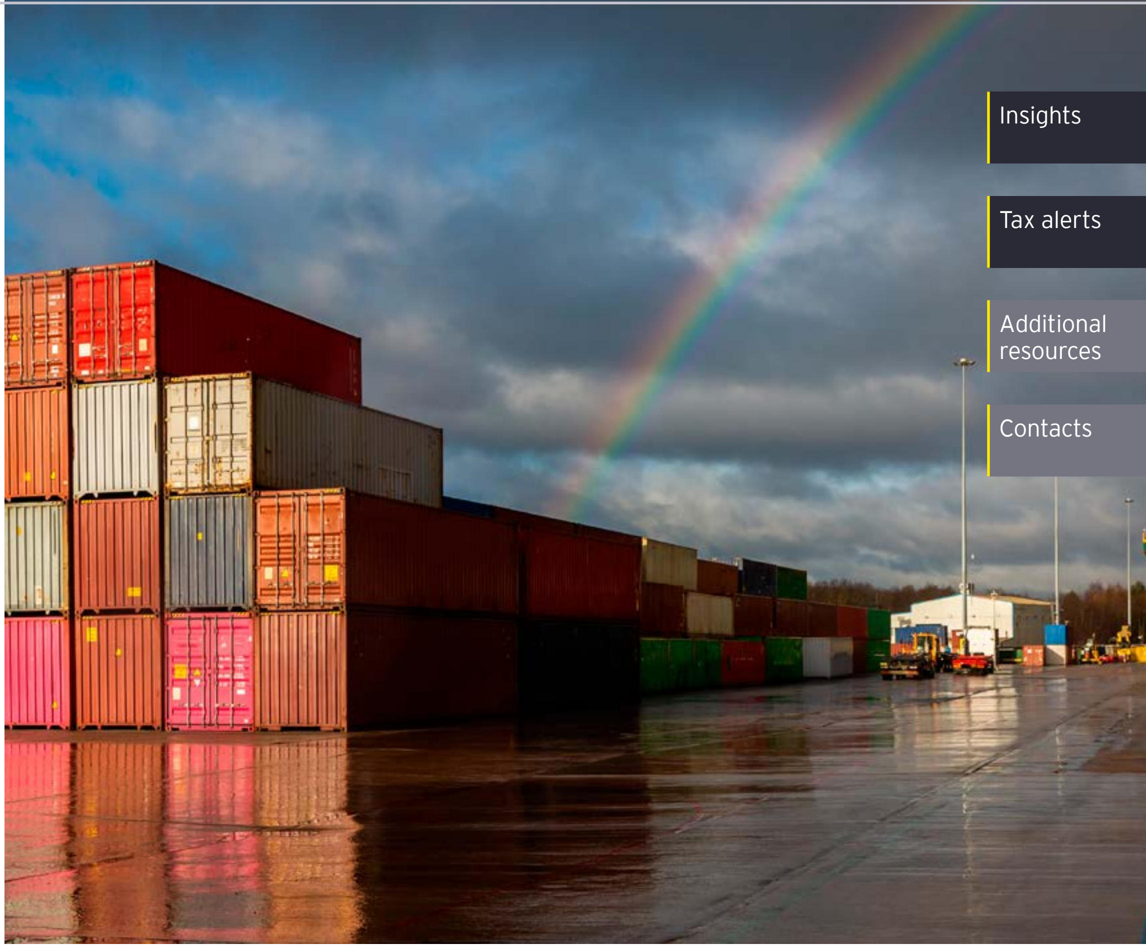
UK: Top seven trade trends in 2023



We are predicting another busy year for international trade in the UK in 2023. As British companies try to keep on top of these developments, we will be watching these seven trends through the coming year.

1. Slower trade negotiations

The UK's trade negotiations agenda will likely slow in 2023, with a greater focus on ratifying and implementing the agreements that the UK has negotiated since 2016.

- **UK-India Free Trade Agreement (FTA):** After failing to meet the self-imposed deadline of Diwali 2022, the UK and India will continue to negotiate an FTA in 2023. Reports suggest that negotiations have been challenging, particularly around some of the UK's interests in digital trade and the services sector. We predict a breakthrough in negotiations in the second quarter of 2023, with the final agreement coming later in the year.
- **Acceding to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP):** The UK applied to join the CPTPP in 2021, and negotiations are continuing with the jurisdictions involved. As the UK is the first jurisdiction to go through accession, CPTPP jurisdictions have been fine-tuning the accession process. Additional jurisdictions that have expressed an interest in joining CPTPP include mainland China, Costa Rica, Ecuador, South Korea, Thailand and Taiwan. However, we anticipate that the process will wrap up in 2023.
- **UK-Gulf Cooperation Council (GCC) FTA:** The UK has launched negotiations with the GCC for a trade agreement. However, we are not expecting to see a finalized agreement in 2023, given the complexities of the negotiating dynamics.
- **Upgrading the UK's FTAs with Mexico, Switzerland, Canada and South Korea:** As part of the UK's efforts to maintain its trading relationships following its departure from the EU (known as Brexit), a large number of rollover or "continuity" FTAs were agreed with countries that had existing trading arrangements with the EU. Things have been going reasonably well on these upgrade negotiations. The extension of the UK-Swiss Services Mobility Agreement has meant that there should not be any disruption while FTA negotiations are underway between the UK and Switzerland.

2. More export controls and sanctions

With the increase in geopolitical instability in 2022 and the ongoing war in Ukraine, we can expect widening export controls and sanctions, and an increased focus on compliance among the US, UK and EU.[1] The expanded scope of sanctions to the professional services sector and IT-related services means that more companies now need to be aware of these regulations when working with their clients.

The US government will continue to focus on the series of major updates to the Export Administration Regulations it made in 2022 focused on export controls around semiconductors, integrated circuits, related manufacturing equipment, advanced computing and supercomputers. Companies around the globe need to be aware of these developments and their impact on supply chains and business operations.

3. Green trade as a point of contention

Traditionally, "green trade" has been a positive point for countries to cooperate toward greening international supply chains and reducing the environmental impact of trade. However, in 2023 we predict that it will become another geopolitical flashpoint as countries try to corner the market in high-value green goods and services.

An early preview of this may be seen in connection with the US Inflation Reduction Act (IRA), which, among other matters, sets out minimum domestic content provisions for US electric vehicle production to be eligible for government subsidies. Many US trading partners, including the EU, Japan and the UK, have raised concerns about the protectionist nature of these measures, which have yet to be resolved at the time of writing. On 1 February 2023, the European Commission responded by issuing "A Green Deal Industrial Plan for the Net-Zero Age,"[2] which looks to establish new industrial benchmarks, relax subsidy rules and repurpose EU funds.

The EU's Carbon Border Adjustment Mechanism (CBAM) is another green trade development to watch. It is due to enter into force in October 2023.[3] The CBAM will initially cover a number of specific products in some of the most carbon-intensive sectors, such as iron and steel, cement, fertilizers, aluminum, electricity, and hydrogen, as well as some precursors and a limited number of downstream products. The EU CBAM will clearly impact imports of these affected products into the EU, but it may also influence trade policy in other countries, with possible future CBAM mechanisms being considered in countries such as Japan.

4. Supply chain pressures are easing but still remain

Shipping prices and other key supply chain indicators have started to ease. However, supply chains will continue to be under considerable pressure. A combination of US-China decoupling, the war in Ukraine, governmental incentives in many parts of the world for onshoring and regulatory requirements for companies to have greater visibility over their supply chains[4] will mean that we will continue to see broad shifts in companies' procurement and sourcing decisions.

5. Digitalization of trade

This year will likely see the passing of the Electronic Trade Documents Bill through the UK Parliament. This will allow for the digitalization of an important trade document, the Bill of Lading, and provide a large impetus for a wider modernization of trade processes through the use of different types of trade technology.

1 Our *2023 Geostrategic Outlook* presents our view of the most likely and impactful developments in the geopolitical landscape in 2023. Our article "How to shift strategy for a new geostrategic era in 2023" highlights the findings of this report. Find it here

2 "A Green Deal Industrial Plan for the Net-Zero Age," *EU Commission website*, 1 February 2023. Find it here

3 For further information, please refer to our article 'EU: Updated CBAM regulation published' on page 42

4 "How to shift strategy for a new geostrategic era in 2023," *EY website*, 13 December 2022. Find it here

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6. Brexit is still here

On 27 February 2023, negotiations between the UK and the EU concluded with the "Windsor Framework" which amends the text and provisions of the original Northern Ireland Protocol which was agreed as part of the UK's exit from the EU. The changes under the Windsor Framework include easements to goods traded from Great Britain to Northern Ireland, VAT rules, parcels and includes new governance mechanisms.

More broadly, UK businesses should continue to monitor for regulatory divergence between the UK and EU, which might impact their operations and continue to understand when the extended easements around UK conformity assessment marks and other measures eventually end.

7. A difficult year for the World Trade Organization (WTO)

While the decline of the WTO has been often overstated since it was created in 1995, nonetheless, 2023 is going to be a difficult year for the organization. Since the ministerial conference in June 2022,[4] very little progress has been made on the all-important topic of WTO reform.

The countries that make up the WTO have until early 2024 to make progress, when ministers will next meet in the United Arab Emirates (UAE) for the 13th Ministerial Conference. This is taking place against a backdrop of continued disagreements over the so-called Trade-Related Aspects of Intellectual Property (TRIPS) Waiver, which was agreed for COVID-19 vaccinations but not extended to therapeutics and diagnostics.

The refusal of the US to allow the appointment of appellate body members and restore the dispute settlement function of the organization took another hit when a dispute panel ruled against the US' invocation of the national security exemption brought by China over certain measures that the US had taken in relation to Hong Kong.

Limited progress in the plurilateral negotiations on digital trade, investment facilitation and other discrete areas can be expected, but large-scale breakthroughs of the full multilateral negotiating agenda are unlikely.

Designing a proactive trade strategy

The seven trends highlighted above are only some of the opportunities and challenges UK businesses are likely to face in their international operations over the coming months. Given all the potential for change, now is the time for businesses to reassess priorities, focus on building strategic trade capabilities, understand where value lies in supply chains and boost supply chain resilience.

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4 Further information is provided in our article "What the WTO's 12th Ministerial Conference means for business," *TradeWatch* Issue 2, 2022, page 15, *EY website*. Find it here

Europe, Middle East, India and Africa

Belgium
- Belgian Finance Minister launches proposal for tax reform
  (07 March 2023)

Global
- Global Tax Policy and Controversy Watch
  (20 February 2023)

Ethiopia
- Ethiopia introduces social welfare levy on imported goods
  01 December 2022)

European Union
- The Northern Ireland Protocol and the Windsor Framework
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- European Commission publishes proposal for a "Green Deal Industrial Plan for the Net-Zero Age"
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- EU importers face customs valuation uncertainty and risk
  (13 January 2023)
- A review of three key environmental tax changes to take place in 2023
  (03 January 2023)
- European Parliament and Council reach provisional agreement on EU Emission Trading System reform with implications for EU Carbon Border Adjustment Mechanism
  (21 December 2022)

Germany
- German Federal Parliament approves Single-Use Plastics levy, Federal Council approval is next step
  (03 March.2023)

Ghana
- Ghana implements online process for Tax Clearance Certificate applications
  (01 March 2023)

India
- Australia-India Economic Cooperation and Trade Agreement enters into force
  (09 January 2023)

Italy
- Italy issues 2023 Budget Law
  (10 January 2023)

Kenya
- Kenya publishes draft National Green Fiscal Incentives Policy Framework
  (17 February 2023)
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  (08 February 2023)

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- Expert committee propose changes to Norwegian tax system
  (12 January 2023)

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- Pakistan increases Sales Tax and Federal Excise tax rates
  (15 March 2023)

Poland
- Poland issues draft regulations on mandatory electronic invoicing
  (07 December2022)

Saudi Arabia
- Saudi Arabia announces third wave of Phase 2 e-invoicing integration
  (24 March 2023)
- Saudi Arabia announces second wave of Phase 2 e-invoicing integration
  (28 December 2022)
- Saudi Arabia extends tax amnesty initiative
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- Clarifications and further guidance provided for plastic packaging tax which came into force on 1 January 2023
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- A review of three key environmental tax changes to take place in 2023
  (03 January 2023)

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- Türkiye announces customs exemption regarding aid materials sent from abroad in response to recent earthquakes
  (07 February 2023)

United Arab Emirates
- Dubai reinstates former import value threshold of consignments
  (15 March 2023)
- Dubai reduces threshold for imposing customs duties on imports of consignments
  (12 January 2023)

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- UK increases Plastic Packaging Tax rate
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- UK Chancellor delivers Spring Budget 2023
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- The Northern Ireland Protocol and the Windsor Framework
  (06 March 2023)
- UK packaging waste regulations are effective as of 28 February 2023
  (02 March 2023)
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