

TradeWatch

EY Global Trade

Issue 1 2023



Building a better
working world

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Welcome to Issue 1 2023 of *TradeWatch*



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TradeWatch Magazine

Welcome to Issue 1, 2023 of *TradeWatch*, the EY organization's global trade magazine. In this first edition of the year, we see several of the trade trends that we identified in 2022 – supply chain disruption; a focus on environmental, social and governance (ESG) matters; and ongoing uncertainty around customs valuation – are still high on the agenda, and they are still presenting challenges and opportunities for businesses.

Customs valuation and transfer pricing

Customs valuation is one of the hottest trade topics currently, particularly a focus on how to apply the correct customs valuation to imports of goods from related parties. Different approaches by customs authorities are creating a great deal of uncertainty for multinationals, increasing the risk of disputes

and assessments. We have reported on this topic frequently in *TradeWatch*, and we continue to explore it in this issue. We look at the interplay of transfer pricing and customs valuation in Brazil ([page 5](#)), where new transfer pricing guidelines have recently been introduced, and in the UK, where new tax authority guidance throws significant doubt on the use of customs valuation Method 1 for intercompany imports ([page 48](#)). In this issue, we also focus on the European Union's binding valuation information process ([page 36](#)), a potential opportunity for EU importers to gain certainty about their customs values in the future.

Supply chain disruption

Recent global events, such as the COVID-19 pandemic, trade disputes, new trade alliances and the war in Ukraine, have disrupted international supply chains and influenced trade policy and strategic trade decisions. In 2023, we continue to experience high levels of trade disruption arising from these events and from their ongoing effects. For example, as a result of the war in Ukraine, countries continue to impose or increase sanctions and resettle sources and supplies of vital energy products ([page 39](#)), and we are seeing stricter export controls for technological products from the US to China ([page 22](#)), also affecting supplies for other parts of the world to China.

Sustainability and ESG

ESG concerns have also come to the fore with a growing awareness of the need for action. Governments are using tax and trade policies to

meet their ESG commitments, for example, by introducing taxes, levies and business incentives aimed at cutting carbon emissions, combatting pollution and waste, and protecting biodiversity. Governments are also taking more measures to regulate protections for society and human rights.

Many of these measures relate to how goods are produced and traded across borders. As a result, the commercial impacts and the related reporting obligations are falling on the trade function, requiring trade professionals to take on additional responsibilities and to adapt their roles within their organizations. Key upcoming developments in this sphere that directly affect the trade function include the introduction of the European Union's carbon border adjustment mechanism (CBAM) on 1 October 2023 ([page 42](#)) and the EU's deforestation regulation effective from 1 January 2024.

In this environment, it is crucial for multinationals to be aware of the regulations that affect them and the compliance obligations they face, and to have detailed information about all aspects of their supply chains and of all the parties involved. In this issue of *TradeWatch*, we feature controls on the exportation of strategic goods from the Philippines ([page 33](#)) and measures in Canada to prevent the use of forced labor ([page 12](#)).

The phased introduction of the Corporate Sustainability Reporting Directive as of 1 January 2024, for example, will emphasize the importance of having accurate data across extended supply

chains. And the importance of having detailed data from suppliers and customers about raw materials, product composition or end use will only grow as more measures are introduced. Milestones in the coming year include the end of the transitional period for reporting for the Spanish Plastic Tax on 1 July 2023 and the proposed application of the plastic tax in Italy from 1 January 2024.

Technology

Increasingly, customs authorities are looking to technology to allow them to function more efficiently. These developments may increase the use of post-entry audits and the risks of scrutiny for traders, but they can also greatly facilitate international trade. In this issue, we see measures being taken by customs authorities in Indonesia, Japan and South Africa to use technology to improve importation processes ([pages 26 and 29](#)).

The changing role of the trade function

As a result of these trends, trade functions are managing new regulations, risks and opportunities – often at pace and with limited resources. They are also facing greater scrutiny than ever from an extended ecosystem of suppliers, customers, regulators and other stakeholders.

However, if trade functions adapt, they are poised to play a more strategic role in helping their organizations to meet these challenges and to seize the opportunities that arise in the revised global trade landscape.

Keep up-to-date with developments in trade

We hope you enjoy this edition of *TradeWatch*. We aim to reflect the key trends affecting international businesses and provide news and insights you can use to inform your trade strategy and improve your trade operations.

These are topics we expect to explore further in future thought leadership publications and during our upcoming in-person Global Trade Event at the EY Global Indirect Tax Symposium, from 18 to 20 April 2023 at the hotel Pullman Montparnasse in Paris.

You can also keep up-to-date with developments in global trade by subscribing to EY Tax Alerts and to future editions of our *TradeWatch* and *TradeFlash* publications by visiting ey.com/globaltrade.

If you would like more information on any of the topics covered in this issue or how they may impact your business, please reach out to the authors listed with the articles or any of the EY Global Trade professionals listed in the contacts section of the magazine. We also welcome your feedback and suggestions for future editions. ■

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1 December 2022

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Brazil: New transfer pricing rules and their impact on customs valuation

The Brazilian government has published new transfer pricing (TP) rules adopting the arm's-length principle. These rules could impact the current process of using TP information for assessing customs valuation when importing goods from related parties.

Alignment of Brazilian TP rules to OECD TP standards

On 29 December 2022, the Brazilian government published Provisional Measure 1,152/2022¹ adopting the TP standards of the Organisation for Economic Co-operation and Development (OECD).² The new legislation revokes current Brazilian TP rules. New rules, which should be approved by the Brazilian Congress within 120 days, will be in effect from 1 January 2024, but companies may adopt the new standards in 2023.

What will change?

The implementation of the new TP rules seeks to:

- ▶ Align Brazilian TP rules to OECD standards.
- ▶ Adopt the arm's-length principle for all cross-border intercompany transactions.³
- ▶ Avoid double taxation and double "nontaxation" outcomes.
- ▶ Remove one of the main obstacles to the recognition of tax credits in the US for income tax paid in Brazil.



The traditional Brazilian approach to TP has not previously been aligned to OECD standards. Rather than applying the arm's-length principle to define and prove that intercompany transactions were not controlled by the relationship between the parties, the Brazilian legislation defined fixed margins on cross-border intercompany transactions; any variation between the statutory margins and the actual margins practiced by the parties would then be subject to TP adjustments. Converging the Brazilian legislation to OECD standards, the fixed margins will no longer be applied, and transfer pricing studies on the arm's-length principle will be the new approach for companies to base, test and support their transfer prices and margins.

Transfer pricing and customs valuation in Brazil – background

On 23 June 2022, through Normative Instruction 2,090 (IN RFB 2.090/22), the Brazilian Federal Revenue Service (RFB) formalized the possibility of

1 "Brazilian Government publishes Provisional Measure adopting arm's-length principle", *EY website*, 30 December 2022. [Find it here](#)

2 "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022", *OECD website*, January 2022. [Find it here](#)

3 The arm's-length principle is endorsed by the OECD and is outlined in Article 9 (the Associated Enterprises Article) of the OECD Model Tax Convention on Income and on Capital.

using certain TP information for the purposes of assessing the customs value declared by Brazilian importers when importing goods from related parties. This procedure has been adopted for customs audit purposes in recent years.

However, the use by the Brazilian customs authorities of parameter prices established by the TP rules on a product-by-product basis to validate the customs value has triggered different interpretations between taxpayers and tax authorities. Taxpayers have asserted that the parameter prices do not reflect the reality of prices actually applied to the local sales and, therefore, they were not a suitable basis for challenging the taxpayers' declared customs values in Brazil.

With the introduction of PM 1,152, which has modified the TP rules in Brazil, the possibility that TP studies will be used to facilitate the auditing of declared customs values has potentially been strengthened. The new TP rules differ from the former rules as they are not based on deemed and fixed margins. Instead, they are focused on an analysis of the functions performed and risks assumed by each party in the transaction, as well as on the methods geared to identifying a proxy value that would be practiced between independent parties, aligned with the arm's-length principle. This new approach is broadly aligned with the goals of the customs valuation rules.

Customs valuation insights and considerations based on new legislation

- ▶ The adoption of the new arm's-length principle will increase the focus on transfer pricing studies performed by importers in a way that has not been done before, in order for the customs authorities to test the conditions of sale and that the relationship between the buyer and seller has not influenced the price paid.
- ▶ With the new focus on local TP studies as a form of defending declared customs values, it will be important for importers in Brazil to validate that TP studies performed in Brazil are adequate from a customs standpoint and pass the arm's-length principle "condition of sale test" (i.e., whether an examination of the conditions of the sale between the related parties indicates that their relationship did not influence the price paid or payable for the goods imported into Brazil).

- ▶ If the Brazilian customs authorities maintain their high level of auditing focus on intercompany transactions but adopt the arm's-length principle approach through the new TP rules, it will be important for Brazilian importers to examine their intercompany pricing closely.
- ▶ Even though Brazilian regulations allow TP studies to be used as a basis for the conclusion that the relationship between the parties influenced the price in a given intercompany transaction, it may not be the exclusive factor taken into account, particularly if the attempt is to use transfer pricing studies as the basis for the company's customs valuation, because customs authorities would still seek to apply their own tests and regulations, in addition to TP studies, in line with the World Customs Organization and Technical Committee on Customs Valuation notes, for example. Therefore, direct tax and Customs agencies within the Brazilian government will still adopt slightly different approaches when investigating significant fluctuations in intercompany pricing.

What's next?

The new TP rules will be in force as of 1 January 2024, but taxpayers may choose to follow and apply them in 2023. It is important to note that if the option is exercised to follow the rules for 2023, it will be irreversible.

Under these circumstances, a harmonized approach between the customs valuation rules and the content of a company's TP studies becomes essential. This will help Brazilian importers to demonstrate that the price paid or payable in intercompany transactions has not been influenced by the relationship between the parties such that the price practiced is divergent from a fair and logical market price. This will consequently help to manage the risk that the Brazilian customs authorities could reject the transaction value as an appropriate parameter for evaluating the declared value of the goods at import. ■

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Canada: Border Services Agency (CBSA) releases guidance on Select Luxury Items Tax enforcement and administration

On 1 September 2022, the Select Luxury Items Tax Act (SLITA) came into force. The SLITA imposes a “luxury tax” on the importation of certain vehicles, aircraft and vessels valued above certain price thresholds. Importers of these vehicles, aircraft and vessels are required to pay this tax on the subject item, in addition to any other applicable customs duties and taxes.

The CBSA published Memorandum D18-4-1: *Select luxury items tax on importation*¹ to clarify how the agency enforces and administers provisions under the SLITA and the Customs Act specific to subject imported items. This article summarizes the key guidelines in that memorandum.

¹ “Memorandum D18-4-1: Select luxury items tax on importation,” *Government of Canada website*, 6 October 2022. [Find it here](#)

Luxury tax application

The new tax is assessed on imports into Canada of subject goods, as set out in subsection 2(1) of the SLITA. Tax applies to vehicles and aircrafts valued at CAD100,000 or more and vessels valued at CAD250,000 or more.

Subject vehicle means a passenger motor vehicle that:

- ▶ Is designed or adapted primarily to carry individuals on highways and streets
- ▶ Has a seating capacity of 10 individuals or fewer
- ▶ Has a gross vehicle weight of 3,856 kg or less
- ▶ Is manufactured after 2018
- ▶ Is designed to travel with four or more wheels in contact with the ground

This includes sedans, coupes, hatchbacks, convertibles, SUVs and light-duty pickup trucks. Ambulances, hearses, motor vehicles that are marked and equipped for policing, vehicles used in emergency medical and fire response activities, or recreational vehicles that are designed or adapted to provide temporary residential accommodation are excluded.

Subject aircraft means an airplane, glider or helicopter, as defined in subsection 101.01(1) of the Canadian Aviation Regulations, that is manufactured after 2018 and is equipped:

- ▶ Only with pilot seats and cannot have any other seating configuration
- ▶ Only with pilot seats or is not equipped with any seats, and cannot have a seating configuration, excluding pilot seats, of 40 or greater
- ▶ With one or more pilot seats and one or more passenger seats and has a seating configuration, excluding pilot seats, of 39 or fewer

Subject aircraft does not include an aircraft designed and equipped for military activities or an aircraft equipped only for carrying goods.

A *subject vessel* is a vessel that is designed or adapted for leisure, recreation or sport activities and was manufactured after 2018. It does not include floating homes, commercial fishing vessels, ferries or cruise ships. For SLITA purposes, vessel means a boat, ship or craft that is designed or is capable of being used solely or partly for navigation in, on, through or immediately above water, without regard to the method or lack of propulsion.

Luxury tax calculations on imports

When calculating the taxable amount of certain luxury goods at importation, the applicable goods and services tax (GST)/harmonized sales tax (HST) and provincial sales tax (PST) are not included in the tax base. In addition, any deductions for a trade-in or down payment do not reduce the taxable amount of a subject item.

All duties and taxes payable must be included in the taxable amount for luxury tax purposes. The taxable amount is the value for duty (VFD) of the item as determined under sections 48 to 53 of the Customs Act, plus any duties and taxes related to customs, other than the GST/HST and PST.

The applicable luxury tax is the lesser of:

- ▶ 20% of the taxable amount above the relevant price threshold of the subject item
- ▶ 10% of the taxable amount of the subject item

GST/HST and PST

GST/HST applies to the final value of the subject item (as determined in accordance with the Excise Tax Act), inclusive of the amount of luxury tax. Where applicable, PST also applies to the final value of the subject item.

Duties and taxes payable

In addition to the luxury tax, all applicable customs-related duties and taxes (e.g., levies imposed under the Customs Tariff, the Excise Tax Act or the Special Import Measures Act) are payable for the import of a subject item, inclusive of GST/HST and PST (if applicable).

Luxury tax payable on import

A person liable under the Customs Act to pay duty on an imported subject item, or who would be liable if the item were subject to duty, must pay luxury tax if the item's taxable amount exceeds the applicable price threshold, unless an exemption applies.

Luxury tax for a subject item is paid and collected in accordance with the Customs Act. Any related interest and penalties must be imposed, calculated, paid and collected in accordance with that act, as if the tax were a customs duty levied under the Customs Tariff.



Exemptions

Section 21 of the SLITA sets out exemptions from the luxury tax for certain imports of subject items. Specifically, an exemption applies if:

- ▶ A subject item is imported by a registered vendor for that type of subject item.
- ▶ A purchaser and a vendor have entered into a written agreement for the sale of the subject item before January 2022.
- ▶ In the case of a subject vehicle, the vehicle was registered with the government of Canada or a province before importation.
- ▶ The subject items are subject vehicles that are equipped for policing activities and imported by a police authority or a military authority, or are equipped for military activities and imported by a military authority.
- ▶ In the case of a subject aircraft or vessel, a tax-paid certificate issued by the Canada Revenue Agency (CRA) for the aircraft or vessel is in effect.
- ▶ In the case of a subject aircraft or vessel, a special import certificate issued by the CRA in respect of the importation is in effect, unless the item is a subject vessel that qualifies as a “select subject vessel.”

In addition, subsection 21(6) of the SLITA sets out “special cases” where tax does not apply for certain temporary importations. For example, the luxury tax on importation is not payable if:

- ▶ The subject item is classified under heading No. 98.01 or tariff item No. 9802.00.00 or 9803.00.00 of the Schedule to the Customs Tariff and no duties are payable in respect of the subject item.
- ▶ The subject item is imported solely for maintenance, overhaul or repair of the subject item in Canada.
- ▶ Neither title to nor beneficial use of the subject item passes to a person in Canada while the subject item is in Canada.
- ▶ The subject item is exported as soon as the maintenance, overhaul or repair is completed.

Temporary importation under tariff item No. 9993.00.00

Luxury tax relief may apply for temporary importations of subject vehicles and subject aircraft under tariff Item No. 9993.00.00 when they qualify as a special case under subsection 21(6) of SLITA.

A subject vessel imported for storage and/or repair under tariff Item No. 9993.00.00 for 12 months may be granted an additional 12 months under that tariff item for the relief of the GST/HST. However, no such additional tax deferral is available for the luxury tax.

Supporting documents – requirements

The CBSA may require supporting documentation for the importation of a subject item if the importer claims an exemption. Such documents may include a proof of valid registration number under the luxury tax regime, a special import certificate, a tax certificate or a written agreement for the sale prior to January 2022.

Declaration and accounting

Commercial goods

Declaration and accounting of items that are commercial goods subject to the SLITA are made in the same way and within the same prescribed time that customs duties and taxes are payable. When accounting for subject vehicles, aircraft or vessels, the importer should complete Form B3-3 (B3), using the method it would normally use when accounting for commercial goods. To account for subject vehicles, aircraft or vessels where luxury tax is payable on the importation, the importer must include the appropriate excise tax code in field 34 of the B3. This code is based on the goods imported and the method used to calculate the luxury tax. For example, excise tax code 61 is used if the item is a subject vehicle, and luxury tax applies at the rate of 10% of the vehicle's taxable amount.

To account for subject vehicles, aircraft or vessels that qualify for exemption, the importer must include the appropriate excise tax code in field 34 of the B3. For example, excise tax code 66 is used if exemption applies because the importer is a registered vendor for the applicable type of subject item.

Casual good (noncommercial)

Declaration and accounting of subject items that are casual goods are made in the same way and within the same prescribed time that customs duties and other taxes are, or are not, payable. If the luxury tax has already been paid, importers should keep any documentation, receipts and/or certificates that demonstrate payment.

Special cases

Luxury tax is payable in full when the subject item is classified under tariff item nos. 9806.00.00 (goods bequeathed to a resident of Canada) or 9807.00.00 (settler's effects).

If the subject item cannot be classified under heading Nos. 98.04, 98.05 and 98.16 because the VFD exceeds the amount specified for these headings, the VFD is reduced in accordance with sections 83, 84 and 85 of the Customs Tariff. The reduced value is used to establish the taxable amount and determine whether the tax applies.

Correction, refund, redetermination and further redetermination

Commercial goods

An importer who has reason to believe that a declaration of origin, tariff classification or value for duty is incorrect is required to correct it. The 90-day period to make a correction starts on the date the importer has, or is deemed to have had, specific information that a declaration is incorrect. Corrections to declarations and requests for refunds should be made on Form B2, *Canada Customs Adjustment Request*.

If an importer is required to pay additional luxury tax or is entitled to a refund, the CBSA will issue a Form B2-1, *Canada Customs – Detailed Adjustment Statement (DAS)*, which serves as a notice of refund or assessment, in response to an adjustment request or in response to a review or redetermination initiated by the CBSA. Note that the CBSA will not grant any drawback in respect of the luxury tax.

Casual good (noncommercial)

Where there is overpayment of luxury tax, an importer may submit Form B2G, *CBSA Informal Adjustment Request*, to the appropriate CBSA Casual Refund Centre to request refund of the amount overpaid.

Commercial goods and casual goods (noncommercial)

The CBSA may redetermine or further redetermine the origin, tariff classification or VFD on its own initiative or in response to an adjustment request. As with customs duties and taxes, the CBSA may assess any undeclared amount of luxury tax.

The Customs Act and the regulations made under that act apply to the determination of the tax status of a subject item as if it were the determination, redetermination or further redetermination of the item's tariff classification. Similarly, the Customs Act and the regulations made under that act apply to the appraisal, reappraisal or further reappraisal of a subject item's value as if it were the appraisal, reappraisal or further reappraisal of the subject item's VFD.

Rebate

An importer seeking a rebate for luxury tax paid under sections 39, 40, 41, 42 and 43 of the SLITA must submit a rebate application to the CRA.

Review

Following a determination, redetermination or further redetermination of the origin, tariff classification or VFD made by the CBSA, an importer may request a redetermination or further redetermination of origin, tariff classification or VFD under the Customs Act.

Administration and enforcement

Examinations and verifications

Importers are required to demonstrate that the goods are not subject to the SLITA and that the importation is not prohibited. They must also provide supporting required documents when an exemption applies.

Importations may be subject to examination at the time of import and to post-release verification for compliance with the origin, tariff classification, VFD, marking programs, and any other applicable programs or provisions administered by the CBSA. If the CBSA encounters noncompliance, in addition to assessments of any applicable duties and taxes, penalties may be imposed and interest will be assessed, where applicable.

Actions for business

The CBSA published Memorandum D18-4-1 to eliminate ambiguity around how SLITA will be enforced effective 1 September 2022. The move to impose a luxury tax on most recreational vehicles, aircraft and vessels of a certain threshold may become a deterrent to importers of subject items, or it may encourage the increased manufacturing of luxury items within Canada, which in turn will foster local production and the export of luxury items.

It is paramount that manufacturers, wholesalers, retailers and importers of subject items assess and monitor their product offerings and pricing to ascertain where they stand within the scope of the luxury tax regime and the relevant price thresholds. Importers of both commercial and casual goods subject to SLITA may find themselves vulnerable to different circumstances of noncompliance and penalties unless well-advised on new legislation. ■

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Canada: Proposes new reporting obligations on modern slavery in supply chains in 2024

Countries around the world are becoming more aware of the need to enact measures to combat modern slavery, both in domestic and international supply chains. The Canadian government is implementing legislation to combat the use of forced labor and child labor in Canadian supply chains. In this article, we consider some recent developments and the reporting obligations that these measures may place on Canadian importers.

Bill S-211

Bill S-211: *An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Act and to amend the Customs Tariff*¹ will impose mandatory annual reporting obligations on government institutions and certain private entities that produce or import goods into Canada. Assuming the bill receives Royal Assent in 2023, covered entities will be subject to the reporting requirements of the bill potentially as early as 1 January 2024; subject entities should begin mapping possible exposure in their supply chains sooner rather than later. Persons or entities that fail to comply with the reporting obligations of the act may be charged with a summary conviction and be liable to a fine not exceeding CAD250,000.



Background

In 2018, the House of Commons Subcommittee on International Human Rights of the Standing Committee on Foreign Affairs and International Development (SDIR) issued a report recommending that Canadian businesses increase their capacity to monitor their supply chains and that greater incentives should be created to eliminate forced labor and child labor from supply chains.²

¹ "Bill S-211: An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Act and to amend the Customs Tariff," *Parliament of Canada website*, 22 November 2021. [Find it here](#)

² "A Call to Action: Ending the Use of All Forms of Child Labour in Supply Chains," *House of Commons Canada*, October 2018. [Find it here](#)

The federal government broadly agreed with the SDIR's report and has since launched several initiatives that aim to promote responsible business practices, including with respect to forced labor and child labor in supply chains. Since the release of the SDIR report, three bills were introduced into Parliament to implement the SDIR's recommendations relating to business supply chains and forced labor and child labor:

- ▶ Bill C 423, *An Act respecting the fight against certain forms of modern slavery through the imposition of certain measures and amending the Customs Tariff*³ was introduced as a private member's bill in the House of Commons on 13 December 2018. Bill C 423 would have created an obligation for certain entities to report on measures taken to address forced labor and child labor in their supply chains. It would also have amended the Customs Tariff to prohibit the importation of goods manufactured or produced through forced labor or child labor.
- ▶ Bill S 211: *An Act to enact the Modern Slavery Act and to amend the Customs Tariff*⁴ was introduced as a Senate public bill and received first reading on 5 February 2020; it was substantially similar to the previous Bill C 423.
- ▶ Bill S 216: *An Act to enact the Modern Slavery Act and to amend the Customs Tariff*⁵ was introduced as a Senate bill on 29 October 2020. Although similar to the previous two bills, it added a requirement that the Minister of Public Safety and Emergency Preparedness maintain an electronic registry of reports. It also contained somewhat broader definitions of child labor and forced labor to ensure that those terms would include child labor and forced labor as defined in the Worst Forms of Child Labor Convention 1999⁶ and in the Forced Labor Convention 1930, respectively.⁷

All three bills died on the Order Paper before their third reading, and none were considered in Committee. Therefore, none of them was enacted as law.

The current Bill S-211 is similar to Bill S-216, with the added reporting obligation for government institutions. Bill S-211 was introduced in the Canadian Senate (the Upper House of the Canadian Parliament) in 2021. The bill passed all three required readings in the Senate on 28 April 2022.

As of January 2023, the bill has passed a second reading in the House of Commons (the Lower House of Parliament) and is currently at the report stage. Bill S-211 will need to pass a third reading in the House of Commons before it can receive Royal Assent and enter into force. According to section 28 of the bill, the provisions of the bill come into force on 1 January of the year following the year in which it receives Royal Assent (therefore, 1 January 2024, if it receives Royal Assent in 2023).

Reporting requirements for nongovernment institutions

Part 2 of Bill S 211 requires entities that produce, sell or distribute goods, or import goods into Canada, and that meet certain threshold requirements, to submit a report to the federal government.

An "entity" is defined as a corporation, trust, partnership or other unincorporated organization that:⁸

- ▶ Is listed on a stock exchange in Canada
- ▶ Has a place of business in Canada, does business in Canada or has assets in Canada and that, based on its consolidated financial statements, meets at least two of the following conditions for at least one of its two most recent financial years:
 - (i) It has at least CAD20 million in assets.
 - (ii) It has generated at least CAD40 million in revenue.
 - (iii) It employs an average of at least 250 employees.
- ▶ Is prescribed by regulations

3 "Bill C-423: An Act respecting the fight against certain forms of modern slavery through the imposition of certain measures and amending the Customs Tariff," *Parliament of Canada website*, 13 December 2018. [Find it here](#)

4 "Bill S-211: An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Act and to amend the Customs Tariff," *Parliament of Canada website*. [Find it here](#)

5 "Bill S-216: An Act to enact the Modern Slavery Act and to amend the Customs Tariff," *Parliament of Canada website*. [Find it here](#)

6 "Worst Forms of Child Labour Convention, 1999 (No. 182)," *United Nations website*. [Find it here](#)

7 "Forced Labour Convention, 1930 (No. 29)," *United Nations website*. [Find it here](#)

8 Bill S-211, Section 2.

Entities that meet the above definition must submit an annual report on or before 31 May of each year to the federal government.

The report must outline the steps, if any, that the entity has taken in the previous fiscal year to prevent and reduce the risk of forced labor or child labor being used at any step of the production of goods by the entity or of goods imported into Canada by the entity.⁹ If the entity is incorporated under the Canada Business Corporations Act¹⁰ or any other act of Parliament, the entity must provide the report, including any revised reports, to each shareholder along with its annual financial statements.¹¹

The report must include the following information in respect of each entity¹²:

- ▶ Its structure, activities and supply chains
- ▶ Its policies and its due diligence processes in relation to forced labor and child labor
- ▶ The parts of its business and supply chains that carry a risk of forced labor or child labor being used and the steps it has taken to assess and manage that risk
- ▶ Any measures taken to remediate any forced labor or child labor
- ▶ Any measures taken to remediate the loss of income to the most vulnerable families that results from any measure taken to eliminate the use of forced labor or child labor in its activities and supply chains
- ▶ The training provided to employees on forced labor and child labor
- ▶ How the entity assesses its effectiveness in ensuring that forced labor and child labor are not being used in its business and supply chains

The report must be approved by the entity's governing body. In the case of a joint report, either the governing body of each entity included in the report must provide approval or approval must be given by the governing body of the entity that controls each entity included in the report.



Penalties

Under section 19 of Bill S-211, every person or entity that:

- ▶ Fails to submit a report
- ▶ Fails to make the report publicly available after submitting it to the government
- ▶ Fails to comply with an order made by the Minister to take measures considered necessary to ensure compliance with submitting a report and/or making the report publicly available
- ▶ Obstructs or hinders a verification of compliance by the government

⁹ Bill S-211, Subsection 11(1).

¹⁰ "Canada Business Corporations Act," Canadian Government website. [Find it here](#)

¹¹ Bill S-211, Subsection 13(2).

¹² Bill S-211, Subsection 11(3)

may be guilty of an offense punishable on summary conviction and liable to a maximum fine of CAD250,000.

If a person or an entity commits an offense, any director, officer, agent or mandatary of the person or entity who directed, authorized, assented to, acquiesced in or participated in the commission of the offense is a party to and guilty of the offense and is liable on conviction to the punishment provided for the offense, whether the person or entity has been prosecuted or convicted.

In a prosecution for an offense under subsection 19(1), it is sufficient proof of the offense to establish that it was committed by an employee, agent or mandatary of the accused, whether the employee, agent or mandatary is identified or has been prosecuted for the offense or not, unless the accused establishes that they exercised due diligence to prevent its commission.

Actions for businesses

Although the potential entry into force of Bill S-211 is no earlier than 1 January 2024, the reporting requirements of the bill are significant, so businesses are encouraged to become familiar with the contents of Bill S-211 to get a head start and begin planning the format and drafting of their reports. It is important to note that as the bill is still at the report stage, there is a possibility that the existing provisions of the bill may be amended with more stringent requirements before it receives Royal Assent.

Furthermore, there is a wider push at the federal level to combat forced labor and child labor. As of 1 July 2020, in line with the ratification of the US-Mexico-Canada Agreement (USMCA), the Customs Tariff was amended to add a provision to Chapter 98 of the Schedule to the Customs Tariff prohibiting entry into Canada of goods that are mined, manufactured or produced wholly or in part by prison labor or forced labor.¹³ In addition, two other bills were deposited in Parliament that passed first reading in early 2022 that address issues similar to Bill S-211:

- ▶ *Bill C-262, An Act respecting the corporate responsibility to prevent, address and remedy adverse impacts on human rights occurring in relation to business activities conducted abroad*¹⁴

- ▶ The purpose of this bill is to prevent, address and remedy the adverse impacts on human rights that occur in relation to business activities conducted by entities abroad.
- ▶ The bill imposes on subject entities a duty to prevent adverse impacts on human rights occurring outside Canada and a requirement to develop and implement due diligence procedures in respect of its activities, affiliates and business relationships.
- ▶ *Bill C-243, An Act respecting the elimination of the use of forced labour and child labour in supply chains*¹⁵
 - ▶ The purpose of this bill is to implement Canada's international commitment to contribute to the fight against the use of forced labor and child labor in supply chains through the imposition of reporting obligations on entities involved in the production of goods in Canada or elsewhere or in the importation of goods produced outside Canada.
 - ▶ This bill's reporting requirements and other provisions are similar to S-211. In mid-2022, the bill's status was officially pending and is not being considered in the current parliamentary session, but it may be reinstated in the next parliamentary session, should Bill S-211 fail to be enacted.¹⁶

These legislative initiatives make it clear that the Canadian government is (1) investing in combating the use of forced labor and child labor in Canadian supply chains and (2) responding to growing pressure from consumers and the general public, who are increasingly involved in and aware of human rights issues in the global supply chain. It appears the Canadian government is aiming to align with other jurisdictions in its efforts at tackling human rights issues and environmental, social and governance (ESG) and corporate social responsibility (CSR) matters more broadly, especially with respect to the US,¹⁷ where ESG and CSR regimes have developed significantly in recent years.

¹³ Tariff item No. 9897.00.00 of the Customs Tariff.

¹⁴ "Bill C-262: An Act respecting the corporate responsibility to prevent, address and remedy adverse impacts on human rights occurring in relation to business activities conducted abroad," Parliament of Canada website. [Find it here](#)

¹⁵ "Bill C-243: An Act respecting the elimination of the use of forced labour and child labour in supply chains," Parliament of Canada website. [Find it here](#)

¹⁶ "Similarities Between Bill C-243 and Bill S-211," House of Commons Debates, Official Report (Hansard), 6 June 2022. [Read it here](#)

¹⁷ Further information is provided in our article "US: Uyghur Forced Labor Prevention Act goes into force," TradeWatch Issue 3 2022, page 31, EY website. [Find it here](#)

While the trend to date is for Canada and the US to separately implement ESG and CSR compliance regimes as opposed to a harmonized bilateral approach, there is enough of a crossover in compliance requirements that would warrant businesses with US-Canada cross-border operations to address forced labor and child labor reporting and other ESG and CSR compliance requirements from a regional perspective, while tracking changes to the compliance or regulatory environment within each jurisdiction.

Going forward, it will be imperative for the supply chain and customs functions of a business to work together with other internal stakeholders not only to comply with reporting requirements but to also plan for and assess the potential financial impacts of any supply chain or sourcing restructuring that may be necessary to comply with legislation or to reduce reputational risk among consumers. The reputational risks are too material and complex to be dealt with by the supply chain function alone and will require close coordination with legal, corporate affairs, procurement and customs functions.

One approach includes the following actions:

- ▶ Adopt a North American or regional approach to compliance with forced labor and child labor reporting and compliance issues.
- ▶ Identify individuals within the business who should form part of a working group or committee to be responsible for reporting and compliance for this topic.
- ▶ Prior to the entry into force of the reporting requirements, conduct a current state assessment and document the processes and information gaps for meeting reporting requirements that may exist, along with an action plan to address the gaps.
- ▶ Implement issue escalation procedures.
- ▶ Determine whether partnering with an external advisor is needed and what role external service providers may play in the company's compliance program. ■



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Colombia: Government increases customs tariff for apparel and footwear imports



Since Colombia has signed more free trade agreements (FTAs)¹, Colombian companies have been able to trade their products on a larger scale. However, the industrial development of each country in the region differs, and this may cause domestic production in certain sectors to be adversely affected by trade agreements. In the case of Colombia, the apparel and footwear industries had not developed technical and operational capacity, which prevented local producers from competing on an equal footing with foreign producers of these items. This created unemployment and economic instability in the country as well as a lack of innovation and competitiveness in this important sector.

The decrees

At the end of 2022, the Colombian government issued two decrees increasing the customs tariff for imports of apparel and footwear:

- ▶ Decree 2598 was issued on 23 December 2022. In this decree, the government partially amended Decree 1881 of 2021 (the National Customs Tariff Code) to establish a 40% ad valorem tariff on imports of any products with most-favored-nation origin for products classified in Chapters 61 and 62 of the National Customs Tariff Code. Chapter 61 contains knitted garments and accessories, while Chapter 62 contains garments and accessories made from flat fabrics. These tariffs will not apply to imports of goods that are shipped to Colombia, nor will they modify any special and differential treatment program in force in Colombia.

¹ For further information, please refer to 'Colombia: Examining the impact of tax reform on free trade zones' on [page 19](#) of this publication.

► Decree 2632 was issued on 30 December 2022. In this decree, the government extended Decree 2279 from 2019, which established a 35% ad valorem tariff on imports of footwear whose declared free-on-board (FOB) value is less than or equal to the threshold determined in the following table.

Customs heading	Threshold USD/ pair of shoes
6401	6
6402	6
6403	10
6404	6
6405	7

Regulatory background

Since 2013, the government has issued decrees aimed at increasing the customs tariff for imports of apparel and footwear. It issued decrees that established compound tariffs that sought to counteract unfair trade competition practices and prevent the importation of apparel and footwear at ostensibly low prices.

At the outset, the compound tariffs used could reach 80% of the customs value of the merchandise. However, the Colombian Tax Highest Court determined that to comply with the maximum tariff levels established in the General Agreement on Tariffs and Trade (GATT), only a tariff of 40% for apparel and 35% for footwear could be established.

Therefore, the last decrees have gone from having compound tariffs to having ad valorem tariffs of 40% and 35%.

Although, in principle, these measures seek to protect, promote and develop the national industry, it may be that at the end of the exercise, the final consumer will see the consequences in the increase of prices for the acquisition of such products, since the importer will have to assume an additional value in the import of its merchandise. In addition, other countries may take actions in connection with the measures, claiming them to be a possible breach of Colombia's commitments before the World Trade Organization (WTO).

FTAs

The regulations establish that the tariff will not affect the special and differential treatment programs in force in Colombia, which means that the benefits of the FTAs that Colombia has signed with different countries in the region, such as Mexico and Peru, will be maintained.

The tariff increases for imported apparel and footwear may increase the level of inflation, if the prices in such an important sector of the economy rise. If so, this could also lead to an increase in smuggling of these items.

However, the decrees may also present an opportunity for Colombian importers operating in this sector to restructure their apparel and footwear import operations, such as by switching to importing these goods from countries that Colombia has FTAs with (e.g., Mexico and Peru). This could, therefore, also be

an opportunity for countries in the region to increase their operations with Colombia in the apparel and footwear trade. ■



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Colombia: Examining the impact of tax reform on free trade zones

On 13 December 2022, Colombia's tax reform law was sanctioned by the President of the Republic, after approval from the Chamber of Representatives. This approval introduces significant changes for free trade zones in Colombia.

Importance of free trade zones in Colombia

Five decades ago, when the free trade zones were created in Colombia, they were established as a national public establishment intended to speed, simplify and facilitate international trade, with special emphasis on the export of products to the

international market. However, due to the country's commitments to the World Trade Organization (WTO) to dismantle all subsidies aimed at increasing exports, it was necessary to amend Law 109 of 1985 with Law 1004 of 2005, which is the current basis of the free trade zone regime.

Law 1004 said companies in free trade zones were no longer compelled to export all of their products and that instead their goods could be sold into the domestic market without limits. In addition, free trade zones stopped being public sector establishments and started to be administered and used by the private sector, allowing new companies to access these benefits, through formal requests.

Free trade zones are geographical areas defined within the national territory where industrial activities of goods and services or commercial activities are developed under special tax, customs and foreign trade regulations. The goods that enter these zones are considered to be outside the national customs territory for import and export purposes.¹ In addition to generating better, more productive supply chains, free trade zones in Colombia have fulfilled the purpose for which they were created,² that is they have:

1. Become a key mechanism for attracting foreign investment and for generating employment.
2. Promoted competitiveness in the regions where they are established, allowing the companies located in them to strengthen their trade activity, which has encouraged economies of scale.

¹ Article 1 of Law 1004 of 2005.

² Article 2 of Law 1004 of 2005



- Promoted the improvement of highly productive industrial processes, with safety, transparency, technology, clean production and good business practices.

The free trade zone regime today

Although the free trade zone regime is a very significant mechanism for international trade in Colombia, it is important to highlight that for a company to enter into a free trade zone and be “qualified” as a user of it, it must comply with certain commitments in terms of investment and employment depending on the type of zone it wishes to trade in, as follows:

Permanent free trade zones

Permanent free trade zones are industrial parks built in a defined area of Colombia in which multiple industrial or commercial users are settled. Investment commitments for new users (either industrial or commercial) range between USD0 and USD1.9 million, depending on the value of the real productive fixed assets (known locally as AFRP)³ that they acquire upon arrival in the free trade zone and during the first year.

Likewise, employment commitments range between creating seven to 50 new jobs, depending on the corresponding investment amounts.

Special permanent free zones

The term *special permanent free zone* refers to a single company (industrial user) located in a defined area of Colombia declared as a free trade zone.

- ▶ The investment requirement for special permanent free trade zones for goods is an amount equal to or greater than USD25 million within the first three years following the declaration of the existence of the free trade zone and a commitment to create 150 new direct jobs.
- ▶ For special permanent free trade zones for services, the investment within the first three years, the investment and employment requirements range between USD1.7 million and USD16.3 million and the creation of at least 150 new direct jobs.

In exchange for these commitments in terms of investment and job creation, the free trade zones have access to important benefits, such as:

- ▶ The nonpayment of customs duties (tariffs) and value-added tax (VAT) on the introduction of goods from the rest of the world into the free trade zone while they remain in the free trade zone
- ▶ Sales between industrial users exempt from VAT, in addition to a VAT exemption for raw materials, parts, supplies and equipment acquired from the national customs territory of Colombia that are necessary for the development of an industrial user’s corporate purposes

- ▶ Corporate income tax at a preferential rate of 20% (not applicable to commercial users), compared to 35% for the rest of the companies in the national customs territory

What is changing with the tax reform?

During the tax reform approval process, the national government seemed to be considering ending the benefits of the free trade zones by imposing requirements that, if not met, would result in the regime ending for many companies. However, after several debates, an intermediate compromise was reached whereby a mixed taxation regime would be created depending on the destination of the sales.

According to article 11 of Law 2277 of 2022, which adopts the new tax reform, the corporate income tax rate for exports from the free trade zone will be 20%, while the tax rate for sales to the national customs territory will be 35% from the year 2024.

To access this mixed taxation regime, between 2023 and 2024, companies located in free trade zones must submit an internationalization and annual sales plan with the Ministry of Industry, Commerce and Tourism, which must contain a maximum net income goal from sales in the national customs territory. If a business does not submit the plan or does not comply with the maximum income objectives, the corporate income tax rate applicable will be the general rate (35%).

³ In Colombia, *real productive fixed asset* is a term incorporated by the Customs and Tax Administration into the national law to classify tangible fixed assets that are acquired to be part of the taxpayer’s assets and that are used directly and permanently within the income-producing activity for the provision of goods and/or services and are subject to depreciation or amortization for tax purposes.

Some users will continue with the preferential tax rate of 20% until tax year 2025. This applies only to offshore free trade zones, industrial users of permanent special free trade zones of port services, industrial users of port services of a free trade zone, industrial users engaged in the refining of petroleum fuels or refining of industrial biofuels, users of services that provide logistics services, and operators and users who have had a growth in gross income of 60% in the year 2022 in relation to the year 2019.

What's next?

These changes present new challenges for the free trade zone regime in Colombia.

- ▶ Companies will be subject to an internationalization and sales plan established by the Ministry of Industry, Commerce and Tourism. This plan must be submitted and accepted before the end of 2024 for the company to be able to access the preferential corporate income tax rate. The process of creating this plan requires preparation, guidance and time, and may include adjustments to the business model when exporting to new markets.
- ▶ Companies that have benefitted from the free trade zone regime that cannot comply with these new rules in the future (e.g., because their focus is the domestic market) will need to change their

business model with a new corporate income tax rate. Given the potential impact, we understand that some companies may consider challenging these changes as unconstitutional, and in this regard, some are filing lawsuits, arguing the provisions violate different constitutional principles, such as legality, investment protection, legal certainty and legitimate trust.

- ▶ In addition, it could be argued that these new conditions should not be aimed against some sectors that will be impacted by removing the preferential rate of 20% because the measures discriminate against activities that play a fundamental role in the economic and social development of the country, such as services provided by Business Processing Outsourcings (BPOs), data centers, tourism and health services. The exclusion of these activities from the legislation could trigger concerns for foreign investors in Colombia. ■



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US: WTO rules against the US in cases involving Section 232 tariffs, China origin-marking

In December 2022, the US lost two major trade disputes at the World Trade Organization (WTO). On 9 December 2022, the WTO ruled the US violated global trade rules when it imposed punitive tariffs on imports of steel and aluminum in the interest of national security. Separately, on 21 December 2022, the WTO found the US violated its obligations in requiring that imported goods produced in the Hong Kong Special Administrative Region (SAR) of China be marked to indicate their origin is China. Because the WTO Appellate Body does not have the requisite number of adjudicators to hear cases, the US' appeals will go unheard. Thus, affected businesses should be prepared to await the outcome.

In March 2018, the US levied additional duties of 25% ad valorem on steel imports and additional duties of 10% ad valorem on aluminum imports under the authority of Section 232 of the Trade Expansion Act of 1962 (Section 232).¹ Section 232 gives the US president broad authority to impose tariffs based on an affirmative declaration by the

Secretary of Commerce that the targeted imports threaten to impair national security.² Section 232 further authorizes the president to take action as necessary to adjust the targeted imports so that they will not threaten to impair national security.³

Further, under the United States-Hong Kong Policy Act of 1992, Congress granted Hong Kong SAR differential treatment from mainland China in certain customs, immigration and trade matters, including country of origin marking.⁴ This treatment was on the condition that China allowed Hong Kong SAR to exercise a high degree of political and economic autonomy. In June 2020, however, the US declared its opinion that the Hong Kong SAR was no longer sufficiently autonomous from mainland China and should no longer be considered a distinct foreign state. This led to a US Customs and Border Protection (CBP) notice that imported goods produced in Hong Kong SAR should no longer be

¹ See Proclamation No. 9705, 83 Fed. Reg. 11,625 (8 March 2018); Proclamation No. 9704, 83 Fed. Reg. 11,619 (8 March 2018).

² 19 U.S.C. § 1862.

³ *Ibid.*

⁴ 22 U.S.C. § 5701-5732.



marked to indicate Hong Kong SAR as their origin but must be marked to indicate China.⁵

The US has defended both the Section 232 tariffs and the China origin-marking requirement at the WTO by invoking Article XXI(b) of the General Agreement on Tariffs and Trade (GATT) 1994.⁶ Under Article XXI(b), a member may take action it considers necessary to protect its essential security interests “in time of war or other emergency in international relations.” Such measures taken for the purpose of protecting essential security interests have historically been understood to be self-judging and, therefore, non-justiciable by a WTO panel. In other words, the invoking member should decide what it considers necessary to protect its essential security interests. Several WTO members, most notably the US, have maintained the position that Article XXI(b) is self-judging.

WTO dispute settlement panels issued four separate reports against the Section 232 tariffs (*United States – Certain Measures on Steel and Aluminium Products*),⁷ concluding the Section 232 tariffs were

not “taken in time of war or other emergency in international relations.”

In its WTO action against the US (*United States – Origin Marking Requirement*), Hong Kong SAR challenged the consistency of the CBP origin-marking requirement under most-favored-nation obligations enshrined in the GATT 1994 and the Technical Barriers to Trade Agreement.⁸ As with Section 232, the US once again invoked the national security exception in Article XXI(b), arguing that the labeling rule was based on determinations implicating US essential security interests relating to democracy and human rights. The dispute settlement panel reviewing the case acknowledged that tensions had risen between the US and Hong Kong SAR but said these had not escalated to an emergency in international relations.

The US has articulated its position that the WTO’s legal conclusions are fundamentally flawed⁹ and has formally notified the Chairperson of the WTO’s Dispute Settlement Body of the US decision to appeal both the *US – Certain Measures on Steel and Aluminium Products* and the *United States – Origin Marking Requirement* reports.

Implications for businesses

The appeal by the US likely means that the WTO rulings will not have any practical effects on businesses, at least for the foreseeable future. As discussed in *TradeWatch* Issue 1 2020 in the article “WTO’s Appellate Body disbands,”¹⁰ the WTO Appellate Body has not had the requisite number of judges since the end of 2019. Without a functional Appellate Body to hear and adjudicate cases, the

country ruled against in a trade dispute can bypass a panel’s decision simply by filing an appeal. In that case, it is possible that an appeal will be significantly delayed, preventing WTO members from adopting the panel reports.

Without adoption of the panel reports, businesses impacted by the Section 232 steel and aluminum punitive tariffs should continue to monitor developments and consider actions that provide alternatives for mitigating the overall impact, such as shifting supply sources and/or manufacturing locations to benefit from reduced tariffs from certain countries, utilizing origin or valuation planning, and various duty deferral regimes.

Similarly, businesses impacted by the China marking rule are encouraged to undertake non-preferential origin reviews (i.e., substantial transformation) to ensure that goods are properly marked. Affected businesses should also ensure supply chain partners can accommodate the conflicting responsibility between origin marking and origin reporting/duty payment for goods imported from Hong Kong SAR. ■

5 See 85 Fed. Reg. 48551 (11 August 2020). [Find it here](#)

6 General Agreement on Tariffs and Trade, Art. XXI(b) (1994). [Find it here](#)

7 “United States – Certain Measures on Steel and Aluminium Products,” WTO Doc. WT/DS544/R (adopted 9 December 2022). [Find it here](#)

“United States – Certain Measures on Steel and Aluminium Products,” WTO Doc. WT/DS552/R (adopted 9 December 2022). [Find it here](#)

“United States – Certain Measures on Steel and Aluminium Products,” WTO Doc. WT/DS564/R (adopted 9 December 2022). [Find it here](#)

“United States – Certain Measures on Steel and Aluminium Products,” WTO Doc. WT/DS556/R (adopted 9 December 2022). [Find it here](#)

8 “United States – Origin Marking Requirement,” WTO Doc. WT/DS597/R (adopted 21 December 2022). [Find it here](#)

9 Statements by the US at the Meeting of the WTO Dispute Settlement Body (27 January 2023). [Find it here](#)

10 “WTO’s Appellate Body disbands,” in *TradeWatch*, Issue 1, 2020, page 12, EY website. [Find it here](#)

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Japan: 2023 tax reform changes to the customs law

On 15 December 2022, the Council on Customs, Tariff, Foreign Exchange and Other Transactions (the Council) under Japan's Ministry of Finance produced a proposal on the revision of customs duty rates and the taxation system, the contents of which were reflected in the 2023 Japan tax reform outline.¹ The tax reform outline received a Cabinet decision on 23 December 2023. Key highlights of the reform include the introduction of tighter control over e-commerce cargo and goods that infringe intellectual property rights. While some items that require changes to the laws still need to be deliberated in Japan's parliament, the Diet, it is expected that most of these proposed changes will enter into force on 1 April 2023.

Tighter control over imports of cross-border e-commerce

Although the expansion of cross-border e-commerce has led to an increase in the number of import declarations in Japan, it has also resulted in an increase of imports of prohibited goods and duty evasion. To address these issues, the following new measures have been proposed:

Change in the content of import declarations

In an effort to more accurately capture the import of cross-border e-commerce cargo² and fulfillment services,³ the Council has proposed that importers of e-commerce cargo must specifically indicate in the import declaration form that the declared goods are cross-border e-commerce cargo (i.e., indicate the name of the e-commerce platform when the goods are sold on such a platform) and also indicate the domestic delivery destination of the goods.

¹ "2023 Japan tax reform outline," *EY website*. [Find it here](#)

² These refer to products that are sold by overseas sellers on e-commerce websites and shipped directly to buyers in Japan.

³ This refers to domestic warehousing and delivery services provided by e-commerce platforms operating businesses for overseas sellers.



In addition, it will be clearly stipulated in the government ordinance that the addresses and names of the importers are to be added to the import declaration. This change will provide the legal basis for making importing these goods under a false name a criminal offense.

Revision to the Attorney for Customs Procedure system

Customs law currently stipulates that if importers with no domicile in Japan (nonresidents) intend to import goods as importer of record into Japan, they may do so by appointing an Attorney for Customs Procedure (ACP) who handles customs formalities on their behalf, and they must notify the appointment to

Customs. However, due to an increase in various inappropriate behaviors in this regard, such as where nonresidents appoint local residents with no knowledge of the import transactions to handle import declarations or where the ACP is immediately dismissed after the import declaration, the Council has proposed the following measures:

- ▶ If a nonresident importer does not notify Customs of the ACP, the Director General of Customs shall specify the deadline by which the nonresident importer is required to submit the notification.
- ▶ If the nonresident does not submit the notification by the specified deadline, Customs shall appoint a domestic person or entity that may have a close relationship with the nonresident importer⁴ as ACP.
- ▶ When submitting the ACP notification, it will be necessary to provide information regarding:
 1. The business of the nonresident importer
 2. The nature of the relationship between the importer and the ACP
 3. Proof of the power of attorney provided to the ACP

In addition, it should be highlighted that the Council is currently separately considering clarifying the definition of importer of record in the Basic Circular of Customs Law by stipulating that an overseas seller should generally act as the importer of record in the case of fulfillment services and cargo importations. It is probable that this change may be reflected in the Basic Circular at around the same time as the other customs-related changes enter into force, i.e., in April 2023.

⁴ This refers to persons who have a special relationship or a close relationship, such as a contractual relationship with the nonresident or e-commerce platform operator used by nonresidents.

⁵ The simplified procedure allows Customs to verify the goods without requesting the holder of the rights for their opinion or evidence.

Expansion of the scope of the simplified customs verification procedure for goods infringing intellectual property rights

Currently, there is a simplified customs verification procedure⁵ whereby Customs may unilaterally determine whether the imported goods infringe trademark rights without having to conduct a detailed analysis if the importer does not challenge the designation. This procedure will now be expanded to cover not just trademark rights but also more broadly various intellectual property rights, such as patent design rights, utility model rights and protected business secrets. The aim is to allow Customs to more effectively crack down on the import of goods that infringe various intellectual property rights, which are on the rise due to the increase in the import of cross-border e-commerce cargo.

Strengthening the penalty provision

Along with revisions to domestic tax laws, the Council proposes to revise the penalty provisions in the Customs Law.

The penalty for imported goods not declared by importers whose import tax amount is greater than JPY3 million will increase from 20% to 30% of the import tax differential for the amount exceeding JPY3 million. Moreover, for repeat offenders who have been penalized in the previous two years, an additional 10% will be levied.

Actions for business

As many of the changes proposed focus on the import of cross-border e-commerce cargo and fulfillment services, companies that are involved in such importations and e-commerce platform providers should closely monitor the developments and review their existing procedures to ensure that they will continue to be compliant with the Customs laws. ■

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Japan/Indonesia: Economic Partnership Agreement – introducing electronic certificates of origin



Introduction of certificate of origin data exchange

In November 2022, the Joint Committee under the agreement between Japan and the Republic of Indonesia for an Economic Partnership Agreement (JIEPA)¹ decided to implement the data exchange of certificates of origin (COs) to simplify operational procedures and facilitate trade between both countries. The committee also adopted the modified operational procedures referred to in Chapter 2 (Trade in Goods) and Chapter 3 (Rules of Origin). This is the first time that Japan has introduced CO data exchange.

It is expected that the pilot operation for CO data exchange will begin in April 2023 and the official operation will be implemented by the end of June 2023.

Switching to CO data exchange

Once the CO data exchange system is in place, importers will be able to submit an electronic CO (e-CO), i.e., CO data transmitted from an electronic system of the authority in the exporting country to the Nippon Automated Cargo and Port Consolidated System (NACCS),² at the time of importing goods under JIEPA preferential duty rates. This means that importers and exporters no longer need to exchange COs in a paper format but will be able to do so by providing the reference number³ of the e-CO.

1 "Japan-Indonesia Economic Partnership Agreement," *Japan Ministry of Foreign Affairs website*, 27 December 2022. [Find it here](#)

2 NACCS is a system dedicated to electronic processing of air and sea cargo, enabling faster and more efficient customs clearance. This system is available only to individuals subscribed to NACCS Center.

3 Using e-CO in Japan (on NACCS) requires an e-CO key, which is the invoice number of the first item that appears on the CO, in addition to the CO number.

The procedures for issuing a CO under JIEPA

a. Exporting goods from Japan

To export products from Japan under the JIEPA's third-party certification system, exporters are required to:

- ▶ Submit documents that certify that the goods to be exported originate in Japan.
- ▶ Register the origin determination.
- ▶ Submit a request for a CO to be issued to the Japanese Chamber of Commerce and Industry (JCCI), the designated issuing authority in Japan.

Previously, for paper COs, exporters were required to receive the CO at the counter of the JCCI and mail it to the importer. These procedures will no longer be required when issuing an e-CO, as it will be delivered directly to the customs system in the importing country. Going forward, exporters will merely be required to apply to the JCCI for the issuance of an e-CO and obtain its approval. Once the operation is fully implemented, JCCI will generally issue e-COs only for the exports covered by the operations under the JIEPA.

b. Importing goods to Japan

Once the CO data exchange system is in place, importers will be able to submit an e-CO instead of a paper CO to Japan Customs at the time of the import declaration when applying JIEPA rates, as the e-CO will be considered as a valid CO under the JIEPA's and Japan's customs laws and regulations. However,

importers in Japan will still be allowed to submit paper COs issued by the authority in Indonesia.

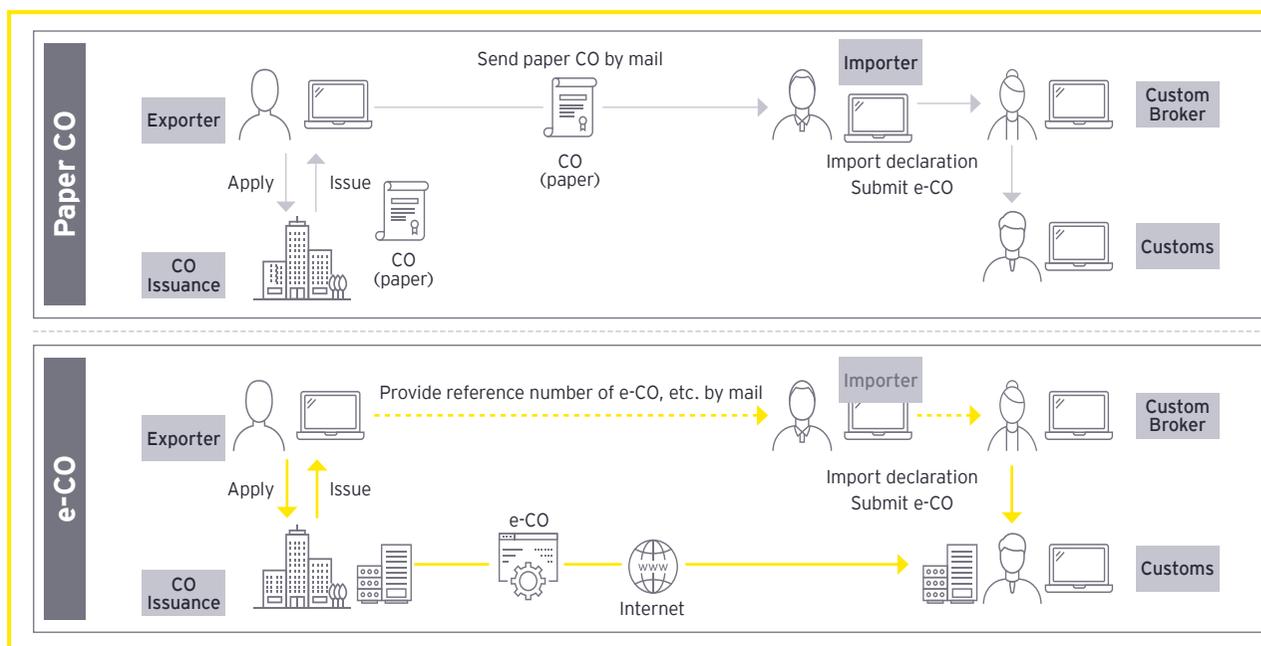
For goods imported under an e-CO, Japan Customs may confirm the originating status of the goods in the light of the JIEPA's provisions during a post-clearance audit. Importers should check the information indicated on an e-CO to ensure that there are no errors with respect to the identity of the items (e.g., names of the importer and exporter, invoice number) as well as the originating status of the items (e.g., HS codes, origin criteria) prior to making an import declaration. Importers are not required to retain a copy of an e-CO submitted to Japan Customs.

Effects of introducing the CO data exchange

The introduction of the e-CO is expected to have the following effects on Japanese importers and exporters:

Simplified and smoother operations:

- ▶ With the direct data transmission from the issuing authority to Customs in the importing country, the operational procedures for delivery of COs among business parties (e.g., importers, exporters, brokers) will be simplified, and the authenticity of the CO will be better secured.



Source: Introduction of CO data exchange under JIEPA, Customs and Tariff Bureau of Ministry of Finance website, 1 February 2023. [Find it here](#)

Insights: Asia-Pacific

- ▶ Where importers need to split a declaration of JIEPA goods into two or more declarations, importers will be able to provide the e-CO to the designated Customs office more easily and smoothly.

Enhanced data utilization:

- ▶ With Customs linking CO data with import declarations for data storage, such data will be more effectively used for inspection at the time of import clearance as well as for confirming the appropriateness of JIEPA application (e.g., whether the rule of origin is fulfilled) at the time of post-clearance audits.
- ▶ Companies may use CO data for a variety of purposes, such as for tracking records and current state analysis.

Additional information for the operational procedures for e-COs will be announced after the official implementation in June 2023. Businesses whose imports or exports may be affected by the new procedures should continue monitoring these developments to be prepared for the upcoming changes. ■

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Indonesia: New customs procedures for importing software and digital goods electronically

The Indonesian Government issued a new Minister of Finance Regulation No. 190/PMK.04/2022 (MOF-190)¹ concerning release of imported goods for use. MOF-190 was promulgated on 15 December 2022 and came into effect on 14 January 2023.

MOF-190 covers changes on import procedures, but the most significant changes relate to the customs procedures around importing software and digital goods through electronic means.

Import of software and digital goods electronically has been covered under Indonesian Customs Law since 2006. Article 8B Paragraph (2) of the Customs Law clearly stipulates that the delivery of software and/or electronic data through electronic transmissions would constitute an import or export. As such, despite not taking the form of physical goods, software and electronic data are considered as goods under the Customs Law. Consequently, the import of software and digital goods is subject to

import duty. However, the procedural rules were not clear in determining the import duty and filing the import declarations.

In early 2018, Indonesian Customs took steps to address this issue by introducing the Harmonized System (HS) codes and import duty tariff for software and digital goods. This allowed the import duty amount to be calculated for the imported software and digital goods. However, there was still no implementing regulation detailing how the importer should report the importation. For physical goods, the importer prepares an import declaration (PIB), which needs specific information, such as the outward manifest, bill of lading and port of discharge. However, this information is not relevant to the import of software and digital goods that are transmitted electronically.

To address this issue, Indonesian government introduced procedures regarding the import settlement of software and digital goods through MOF-190. MOF-190 details the specific procedures for reporting import of software and digital goods to Customs, such as what minimum information should be declared, when it should be submitted and to which Customs office the report should be submitted.

Procedures for declaring the import of software and digital goods

Under MOF-190, the delivery of imported goods for use as intangible goods such as software products

¹ "PERATURAN MENTERI KEUANGAN REPUBLIK INDONESIA NOMOR 190/PMK.04/2022," Republic of Indonesia. [Find it here](#)



and other digital goods may be performed through electronic transmission. However, similar to the importation of tangible goods, there will be customs obligations that should be fulfilled to import these intangible goods, as follows:

- ▶ The settlement of the customs obligation on the importation of intangible goods shall be performed using a customs declaration (PIB).
- ▶ The PIB must be submitted within 30 days from the date of payment for the goods.
- ▶ The PIB should be submitted through a Service Computer System (SKP) to the Customs office where the importer is domiciled or another Customs office.
- ▶ The importer should settle the payment of import duty and import taxes upon importation. The imposition and collection of import duty and import taxes shall be performed in accordance with the provisions of laws and regulations in the customs and tax sector.

The import duty tariffs of software and digital goods vary depending on the HS code of the goods. Software and digital products transmitted electronically that are not related to imported machines or devices are classified under HS Code 99.01 with no import duty tariff. Software and other digital goods transmitted electronically that are related to imported machines or devices are classified with these machines or devices, and the import duty tariff follows the rate that applies to the underlying machines or devices.

In addition to the customs tariff, other import taxes also apply, including income tax under Income Tax Law Article 22 at 2.5% or 7.5% of the import value (depending on whether the importer has an Importer Identification Number (API)) and import value-added tax (VAT) at 11% of the import value.

There are minimum data elements that should be declared on the PIB on the importation of software and digital goods, including the customs office, PIB type, import type, type of payment, sender data, importer data, customs broker (PPJK) data (in terms being authorized to PPJK), invoices, transaction, currency, exchange rate (NDPBM), free-on-board (FOB) value, Cost Insurance Freight (CIF) value, HS code and goods description, country of origin, and type of levy (import duty, excise, VAT/PPN, Luxury Goods Sales Tax (LGST/PPnBM) and income tax (WHT/PPh).

It should also be highlighted that the supervision of settlement of customs obligations on the import of software and digital goods will be performed through the customs audit mechanism. This means that customs officers will review the payment of software and electronic data during customs audits whether they are related to the imported goods or not.

Actions for business

While the Indonesian government has released the procedures for conducting import settlements for software and digital goods through MOF-190, the customs import declaration system has not yet been updated to reflect these changes. The customs system still requires certain information that is

not relevant to the import of software and digital goods to be input the import declaration. Given the situation, at this stage, importers will need to wait until the customs system is updated to reflect the contents of MOF-190.

Nevertheless, since software and digital goods are subject to Customs Law and the government has now issued the regulation with regard to these procedures, importers should begin to establish internal procedures to comply with the new obligation. If there is any doubt concerning the fulfillment of a customs obligation, importers may seek written clarification from the Customs Authority.

The introduction of MOF-190 has led to some confusion around how the new procedures interact or overlap with other tax provisions, potentially leading to double taxation. In particular, providers of digital goods are currently required to collect VAT from their buyers, but the introduction of MOF-190 means that the buyer will also need to pay import VAT to Customs, resulting in the buyer having to pay two types of VAT for a single transaction. This issue of overlapping tax treatments is still unclear and needs further analysis and clarification from the Tax Authority. ■

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Philippines: Customs audits and the Prior Disclosure Program

Four years after the Philippine Bureau of Customs (BOC) resumed conducting customs audits in January 2019, many importers have come forward and voluntarily paid deficiency duties and taxes by making use of the Prior Disclosure Program (PDP).

The Prior Disclosure Program

The PDP is a voluntary disclosure program based on leading international customs practices. It authorizes the BOC Commissioner to accept, as a potential mitigating factor against penalties and interest, disclosure by importers of errors and omissions in their prior import declarations that resulted in the assessment of deficient duties and taxes on past imports. It is both a compliance and revenue measure that aims to generate additional revenues with the least administrative cost both to the government and to importers. It is an option given to importers to comply with the customs laws and regulations. At the same time, the PDP helps importers to avoid undergoing a full customs audit and the steep penalties that apply if there are deficient duty and tax findings in the course of an audit.

What is the status of BOC post-clearance audits?

Since January 2019, the BOC has issued almost 1,000 Audit Notification Letters (ANLs) to importers, covering companies from different industries and groups such as oil and gas, automotive, pharmaceutical, consumer, and users of Super Green Lanes.¹



In January 2023, the BOC reported that 492 importers are recommended for post-clearance audit this year. The companies were identified and selected through the BOC's improved Computer-Aided Risk Management System (CARMS) that identifies potentially incorrect import transactions.

It appears that several companies that were under audit used the PDP. There were also companies that used the PDP process without an ongoing audit.

¹ Super Green Lanes are a trade facilitation measure granted on application to trusted traders. More information may be found at [SGL Requirements](#) | Bureau of Customs.

Based on information from the BOC website, as of June 2022, the BOC has collected about PHP600 million from audit findings and PHP5 billion² from PDP applications filed by importers, whether under audit or not. Based on these figures alone, around 90% of the collection came from PDP applications.

Who may file a PDP and when to file

Importers who are not undergoing an audit may file a PDP at any time. Those undergoing an audit should file the PDP within 90 days from the receipt of the ANL. In this case, the PDP application may be amended within 30 days from the filing of the initial PDP.

Some of the common issues covered by the PDP applications that have been filed include dutiable royalties, upward transfer pricing adjustments, errors in declared values, excise tax on sweetened beverages and industry-specific issues.

Moreover, importers may make use of the PDP without penalty and interest for any of the following:

- ▶ Dutiable royalty payments
- ▶ Other proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller
- ▶ Any subsequent adjustment to the price paid or payable

For these adjustments, the PDP application should be filed within 30 calendar days from the date of payment (or accrual of subsequent proceeds) to the seller or from the date that the adjustment is made to the price paid or payable.

To ensure the approval of a PDP application, the application must be filed on time, it should include a full disclosure of the relevant issues, and the complete documentary requirements must be submitted. Otherwise, the application may be denied.

Penalties for making use of the PDP and waiver applications

While the PDP provides a facility to pay deficient duties and taxes, doing so is subject to payment of a penalty and/or interest, depending on whether the importer is under audit:

- ▶ If the importer is under audit, using the PDP within the 90-day period is subject to a 10% penalty and 20% interest per year.
- ▶ If the importer is not under audit, it is only subject to 20% interest per year.

There are no specific guidelines on the approval of PDP applications with a request for waiver of penalty and/or interest. Therefore, the BOC considers the PDP applications that it will endorse to the Secretary of Finance for approval on a case-by-case basis.

PDP applications of importers with an audit that are found to be complete and accurate are subject to evaluation by the BOC. These applications may be endorsed for approval, depending on the issues involved and the relevant facts and circumstances.

Proactivity is key

It is prudent for importers to review their customs practices and procedures, without waiting for an ANL. Upon determination of an exposure to additional duties or taxes, importers should consider making use of the PDP due to its material benefits, such as potentially reducing the time and resources spent in handling full audits and in avoiding steep penalties and interest arising from deficient duties and taxes. ■

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² Roughly USD11 million and USD91 million, respectively (as of 13 February 2023).

Philippines: Strategic trade management update

The Philippine Department of Trade and Industry – Strategic Trade Management Office (DTI-STMO) released an announcement¹ on 26 January 2023 for all industry stakeholders to properly classify items covered by under the National Strategic Goods List (NSGL), including software and technology.

Background

The Philippines Strategic Trade Management Act (STMA), which passed in 2015, seeks to prevent the proliferation of weapons of mass destruction (WMDs) by managing the trade in certain strategic goods. This is in line with United Nations Security Council Resolution 1540, adopted in 2004, which imposes upon states the obligation to take and enforce measures to establish domestic controls preventing the proliferation of nuclear, chemical or biological weapons and their means of delivery.

Strategic goods in this context are products that, for security reasons or due to international agreements, are considered to be of military importance therefore their export is either prohibited or subject to specific conditions. There is a published NSGL, specifically describing the strategic goods subject to authorization. They are:

- ▶ Military Goods (listed in Appendix 1) – items or technology developed for military use
- ▶ Nationally Controlled Goods (listed in Appendix 3) – goods placed under control for reasons of national security, foreign policy, anti-terrorism and public safety



- ▶ Dual-Use Goods (listed in Appendix 2) – items, software and technology that can be used for both civil and military use or in connection with the development, production, storage or dissemination of WMDs or their means of delivery (e.g., aluminum alloy, machine tools, telecommunication systems and equipment, which are ordinarily manufactured by companies for export or local use)

In addition to the above lists, Section 11 of the law provides for end-use controls to be imposed on strategic goods that are not in the NSGL for which an individual license may still be required, as the goods may be used in the acquisition, development or production of WMDs, or their means of delivery. This is the catch-all provision of the law.

¹ "Commodity Classification Requirement Prior to Registration," Announcement No. 2023-001. [Find it here](#)

Guidance on STMA

The guidance provided on 26 January 2023 by the DTI-STMO covers the classification of items under the NSGL.

Commodity classification is considered to be an integral first activity in strategic trade management, since businesses must determine the applicability of STMA to their operations before applying for registration and authorization, pursuant to the STMA. This is particularly relevant to businesses engaged in the trade of dual-use goods under Annex II of NSGL, or goods designed for commercial applications that can also have military applications or potentially be used as components of WMDs. This is also consistent with the department's previous announcement² on 8 August 2022 no longer allowing the export of strategic goods without authorization starting 1 January 2023.

Since the publication of implementing rules and regulations to STMA in 2018, the DTI-STMO has so far registered 50 entities, issued 24 authorizations and reached out to over 600 enterprises to facilitate consultations and trade awareness forums. It has also pre-audited and approved 12 internal compliance programs necessary to ensure STMA compliance and has audited two companies using its investigative capacity. The DTI-STMO convenes and coordinates with government partner agencies, including the Bureau of Customs (BOC), the Philippine Economic Zone Authority (PEZA) and the Department of Foreign Affairs (DFA), via subcommittee meetings to discuss updates and related risk assessments, as well as to formulate robust interagency enforcement and prosecution measures.

Audits and penalties related to STMA

The imposition of administrative penalties was suspended from 1 July 2020³ until 31 December 2021⁴ due to the COVID-19 pandemic. Nevertheless, DTI-STMO continued to release several pieces of guidance on STMA compliance. In March 2021, it issued a step-by-step guide⁵ on commodity classification, establishing a methodology to properly identify items that should be included or excluded from the NSGL. On 26 October and 9 November 2021, it issued procedures for the registration⁶ and authorization⁷ of businesses engaged in the trade of goods under Annex III of NSGL (nationally controlled goods), as well as on the registration and authorization⁸ (on 28 January 2021) of businesses engaged in related services (brokering, financing and transporting) in relation to the movement of strategic goods between two foreign countries and providing technical assistance. It also issued guidelines⁹ on end-use and catch-all provisions, emphasizing the necessity for conducting constant end-use, end-user and destination country checks.

On 1 August 2022, the DTI-STMO published a memorandum circular¹⁰ on how it conducts compliance checks or audits. In addition, companies engaged in the trade of goods that are visually similar to strategic goods may be covered by a self-certification or an STMO-issued Non-Strategic Goods Certificate (NSGC), based on guidance¹¹ issued in the same year, replacing earlier guidance issued in 2020. To manage administrative and criminal penalties that may be imposed for violations of STMA, the DTI-STMO issued guidelines on voluntary-self-disclosure,¹² allowing companies to submit notification of violations or potential violations to STMA.

2 "No STMO Authorization, No Export of Strategic Goods," Announcement No. 2022-001. [Find it here](#)

3 "Guideline on the Temporary Suspension of Administrative Penalty Under the Strategic Trade Management Act in Light of the COVID Pandemic," Memorandum Circular No. 20-27. [Find it here](#)

4 "Lifting of the Temporary Suspension of Administrative Penalties Under the Strategic Trade Management Act Effective 01 January 2022," Memorandum Circular No. 21-27. [Find it here](#)

5 "Guidelines on Commodity Classification," Memorandum Circular No. 21-10. [Find it here](#)

6 "Guidelines on STMO Registration for Export of Strategic Goods and Covered Persons Under Memorandum Circular 21-06 and 21-37," Memorandum Circular No. 21-40. [Find it here](#)

7 "Guidelines on Authorization Application for the Export, Transit, Transshipment, and Import of Goods Listed Under NSGL Annex 3 or Nationally-Controlled Goods," Memorandum Circular No. 21-37. [Find it here](#)

8 "Implementation of Financing and Brokering Under Republic Act No. 10697 Otherwise Known as Strategic Trade Management Act (STMA)," Memorandum Circular No. 21-06. [Find it here](#)

9 "Guidelines on End-Use or Catch-All Controls," Memorandum Circular No. 21-35. [Find it here](#)

10 "Guidelines on Compliance Checks," Memorandum Circular No. 22-16. [Find it here](#)

11 "Guidelines on Non-Strategic Good Certificate Repealing DTI Memorandum Circular No. 20-03 S. 2020," Memorandum Circular No. 22-05. [Find it here](#)

12 "Guidelines on Voluntary Self-Disclosure (VSD)," Memorandum Circular No. 21-39. [Find it here](#)



Self-regulation by business

The DTI-STMO aims to become a “fully functional office [compliant] with international commitments and obligations in regulating strategic trade by 2028.” By 2028, it will focus on imports of strategic goods and the provision of related services. To realize this vision, it aims to develop the capacity for businesses to self-regulate strategic goods and further enhance the capacity of government partner agencies in identifying strategic items to ease trade flows. Included in its key digital initiatives are plans to develop an IT platform that will serve as a one-stop shop for STMA-related matters and to create an artificial intelligence system that is available 24/7 to assist in commodity classification.

Actions for businesses

With the continued developments in implementation and enforcement of STMA, all industry stakeholders are expected to ensure STMA compliance by initially conducting an internal check, or by seeking advice from experienced customs advisors, as well as consulting with the related government agencies. Businesses are also encouraged to continue to monitor developments on STMA compliance, to ensure audit readiness, as well as the capacity to engage in forums or initiatives aimed at updating policies beneficial to all parties involved. ■

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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](#)

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.

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

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](#)

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.

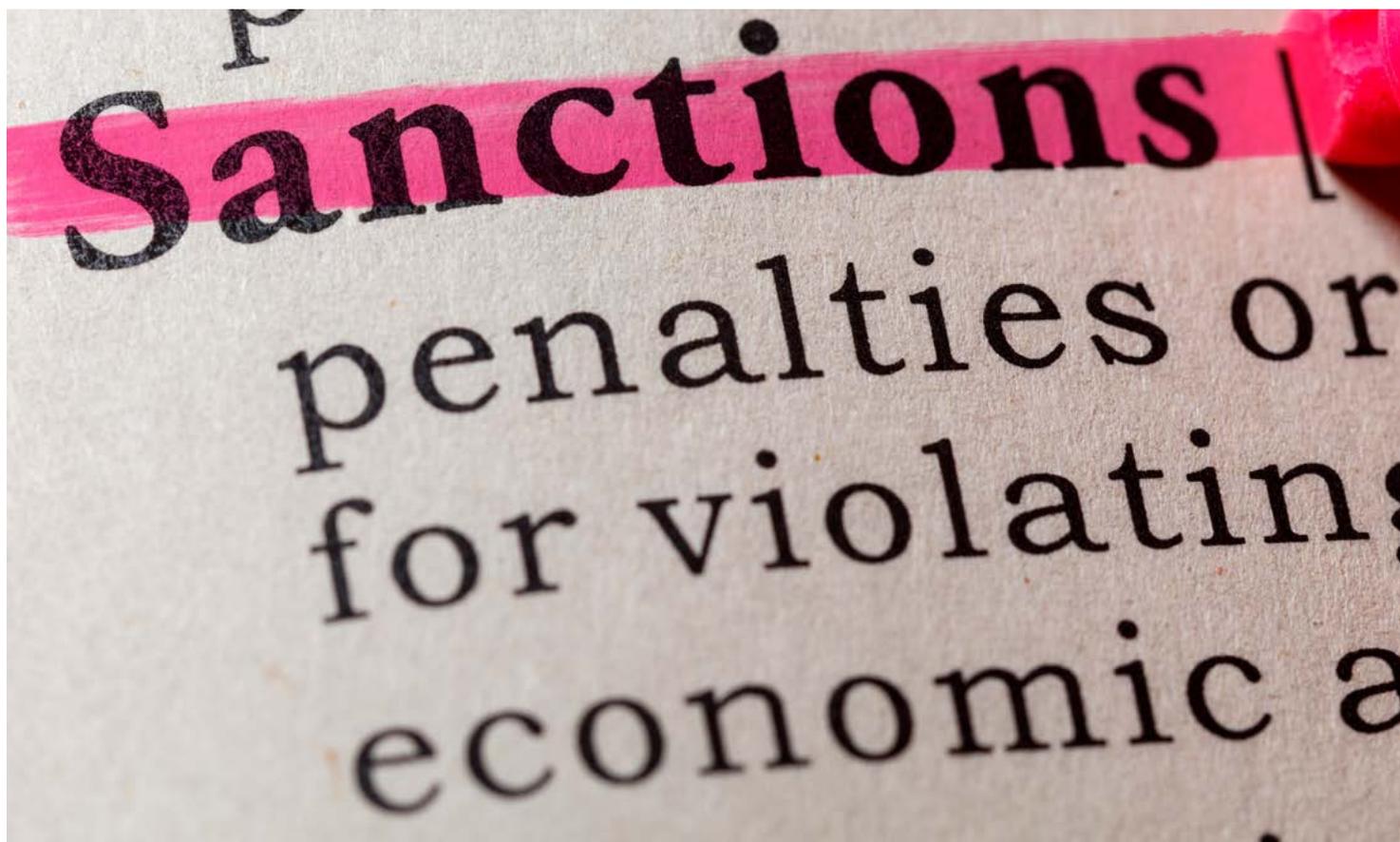
Capacity and workload

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



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

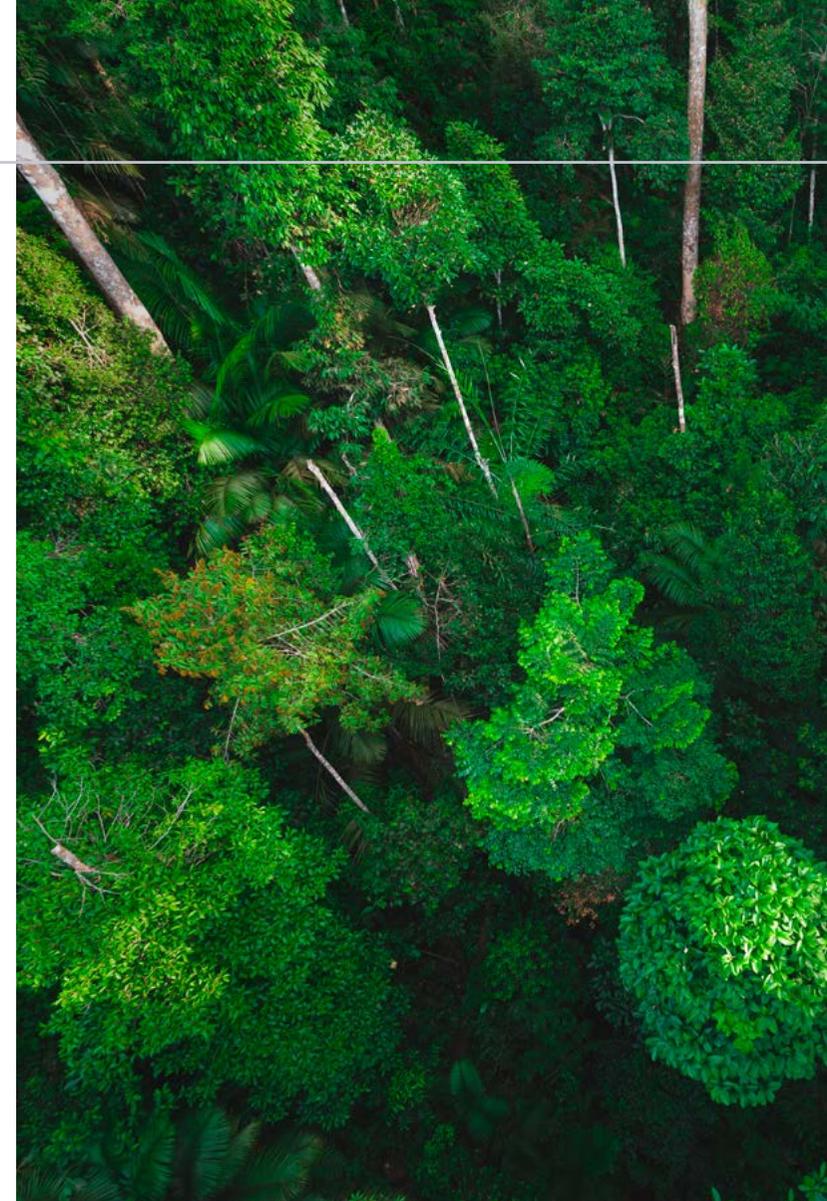
Background

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 CO₂ 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 announcement¹ 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 2030³ 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 chains⁴ 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](#)

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](#)

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Tax alerts

A dark gray world map outline is visible in the background, showing the continents and country borders.

Tax alerts

Americas

Brazil

- ▶ Brazil modifies taxation of fuels and crude oil (07 March 2023)
- ▶ Brazil's new transfer pricing rules and their impact on customs valuation (10 January 2023)

Canada

- ▶ Yukon issues budget (13 March 2023)
- ▶ Alberta issues budget 2023/24 (08 March 2023)
- ▶ British Columbia issues budget 2023/24 (08 March 2023)
- ▶ Nunavut issues budget 2023/24 (28 February 2023)
- ▶ Northwest Territories issue budget 2023/24 (21 February 2023)

Costa Rica

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)
- ▶ Costa Rican Customs Authorities communicate end of temporary relief for maritime freight costs (16 March 2023)
- ▶ Costa Rican General Customs Directorate issues procedures for scanning of containers and goods at entry into the country (09 March 2023)
- ▶ Costa Rican Customs Authorities adjust Customs Information System (TICA) to eliminate 10% tax on imported beers (09 March 2023)

- ▶ Costa Rican Tax Authority modifies requirements for transportation services of goods destined for export to qualify for VAT exemption (07 March 2023)
- ▶ Costa Rica's President signs law that eliminates 10% tax on imported beer (20 February 2023)

Dominican Republic

- ▶ Dominican Republic's Executive Branch publishes General Regulations to new Customs Law (30 January 2023)

El Salvador

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)

Global

- ▶ Global Tax Policy and Controversy Watch (20 January 2023)

Guatemala

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)

Honduras

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)
- ▶ Honduran Government to file new tax reform before the National Congress (22 March 2023)

Nicaragua

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)

Panama

- ▶ Council of Ministers of Economic Integration of Central America establishes US\$3 charge for each DUCA-F transmitted through the SIECA platforms (22 March 2023)
- ▶ Panama's Ministry of Economy and Finance extends term for implementation of electronic invoicing system (01 February 2023)

United States

- ▶ Colorado's new plastic bag fee, effective January 1, 2023, creates new compliance obligations and issues (10 January 2023)

Asia-Pacific

Australia

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

Global

- ▶ Global Tax Policy and Controversy Watch (20 January 2023)

Malaysia

- ▶ Indirect tax measures in Budget 2023 (06 March 2023)

Singapore

- ▶ Singapore passes Goods and Services Tax (Amendment) Bill 2022 (05 December 2022)

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 (06 March 2023)
- ▶ European Commission publishes proposal for a "Green Deal Industrial Plan for the Net-Zero Age" (07 February 2023)
- ▶ 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)
- ▶ Kenya proposes amendments to Excise Duty Regulations (08 February 2023)

Norway

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

Pakistan

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

Poland

- ▶ Poland issues draft regulations on mandatory electronic invoicing (07 December 2022)

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 (06 December 2022)

Spain

- ▶ Clarifications and further guidance provided for plastic packaging tax which came into force on 1 January 2023 (13 December 2023)
- ▶ A review of three key environmental tax changes to take place in 2023 (03 January 2023)

Turkey

- ▶ 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)

United Kingdom

- ▶ UK increases Plastic Packaging Tax rate (17 March 2023)
- ▶ UK Chancellor delivers Spring Budget 2023 (16 March 2023)
- ▶ 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)
- ▶ A review of three key environmental tax changes to take place in 2023 (03 January 2023)

Additional resources



Global trade on ey.com

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

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