

# TradeWatch



Issue 1 2020

## EY Global Trade

Quarterly update

**EY**

Building a better  
working world

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# Customs valuation impact of the OECD/G20 BEPS project

The Organisation for Economic Co-operation and Development (OECD), an international organization made up of 36 member countries<sup>1</sup> that works to enhance international policies, has undertaken efforts to address international tax challenges resulting from “digitalization,” as part of its broader efforts to address base erosion and profit shifting (BEPS).

On 1 October 2019, the OECD Secretariat presented a proposed “Unified Approach” under “Pillar 1” to the members of the OECD/G20 Inclusive Framework on BEPS and subsequently published the proposal for interested stakeholders to submit public comment.<sup>2</sup> The Unified Approach draws on the commonalities of three previous proposals and seeks to outline a consensus-based, long-term solution for addressing tax challenges arising from digitalization for delivery to the G20 in 2020. The proposed approach also sets forth aims of increased simplicity, transparency and tax certainty.

The proposed Unified Approach to international tax reform would be a fundamental change to the system of global taxation. Under the Unified Approach, jurisdictions would have taxing rights beyond the reach of traditional physical presence

nexus concepts, which would allow a portion of profits derived from intellectual property (IP) and digital-related rights to be reapportioned to the country where the consumption occurs, rather than the jurisdiction where the IP is owned. Significantly, the Secretariat’s Pillar 1 proposal includes all consumer-facing business, whether or not the consumer interface is digital. Potentially any business selling to consumers where IP or digital content adds value is within scope.

Changes in the approach to transfer pricing which may result from the Pillar 1 proposal could impact alignment with the rules for customs valuation. The discussions with the OECD Secretariat have confirmed that customs valuation considerations have not yet been considered in the development of Pillar 1.

## BEPS and the efforts to address digitalization

BEPS refers to tax planning strategies used by multinational corporations that exploit gaps and inconsistencies in tax rules to avoid or reduce tax liability. To combat BEPS, over 135 countries and jurisdictions are collaborating within the “OECD/G20<sup>3</sup>



Inclusive Framework on BEPS,” to implement 15 measures, known as the “BEPS package.” The BEPS package provides local governments with various domestic and international instruments aimed at reducing tax avoidance and increasing transparency and consistency among international tax rules.

1 OECD “member” countries consist of: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

2 OECD, Public Consultation Document, Secretariat Proposal for a “Unified Approach” under Pillar One, available at <https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>.

3 The “G20,” or the Group of 20, is an international economic cooperation forum where leaders of developed and developing countries gather to discuss financial and socioeconomic issues. Collectively, the G20 represents approximately 80% of the world’s economic output, two-thirds of global population and three-quarters of international trade. See <https://g20.org/en/about/Pages/default.aspx>.

The tax challenges of the digitalization of the economy were identified as one of the main areas of focus of the BEPS project. In January 2019, various proposals on these topics were organized into two “Pillars” that could serve as the foundation for the consensus-driven tax reforms. The “Two Pillars” to enable collaborative international tax reform are:

1. Search for a “Unified Approach” to the allocation of taxing rights and seeking a transparent and consistent approach to profit allocation and nexus rules
2. The global anti-base erosion proposal “GloBE proposal,” which covers the remaining BEPS issues and seeks to develop rules that would require all internationally operating businesses to pay a minimum level of tax while also avoiding uncoordinated tax rules, increased complexity and risk of over-taxation.

Public consultations for Pillars 1 and 2 were held in November 2019 and December 2019, respectively, and are set to be discussed in January 2020.

### The proposed “Unified Approach” under Pillar 1

The proposed Unified Approach may be summarized as follows:<sup>4</sup>

- ▶ **Scope.** The approach covers highly digital business models, as well as “consumer-facing businesses”, a term not yet defined.

- ▶ **New nexus.** For businesses within the scope, the approach creates a new nexus, not dependent on physical presence but largely based on sales. The new nexus could have thresholds including country-specific sales thresholds calibrated to ensure that jurisdictions with smaller economies can also benefit. It would be designed as a new self-standing treaty provision.
- ▶ **New profit allocation rule going beyond the arm’s length principle.** The approach creates a new profit allocation rule applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (permanent establishment or separate subsidiary) or sell directly or via unrelated distributors. At the same time, for related party transactions, the approach largely retains the current transfer pricing rules based on the arm’s-length principle but complements them with formula-based solutions in areas where tensions in the current system are the highest.

**Three-tier mechanism.** For businesses within scope, there is a three-tier profit allocation mechanism:

- ▶ **Amount A** – Amount A is the new taxing right to the country of consumption based on the new nexus standard (i.e., likely a revenue threshold). Amount A calculates the share of deemed residual profit allocated to each market jurisdiction using a formulaic approach, which may be based on business line or segment profit, and incorporate deemed routine and non-routine profits calculated based upon fixed percentages.

- ▶ **Amount B** – To reduce disputes and achieve greater certainty, Amount B would establish a baseline routine return for marketing/distribution functions taking place in a jurisdiction and utilize transfer pricing adjustments to eliminate double taxation.
- ▶ **Amount C** – Amount C would leverage current rules and introduces binding dispute prevention and resolution measures to eliminate double taxation. Amount C would effectively provide for an adjustment to profit allocation where necessary – e.g., any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

### Illustrations of the three separate returns to the market/user jurisdiction

The proposed Unified Approach provides two illustrations of the three-tiered mechanism, both dealing with streaming services providers – and neither referencing the cross-border sale of goods.

In essence, the analysis may be as follows based on the current proposal. To determine whether a company may be liable for Amount A in a particular country, consider whether the country-specific revenue threshold in that market is met (i.e., the “new nexus”). Where the threshold is not met, Amount A is not due in that particular market jurisdiction.

To determine whether a company may be liable for Amount B in a particular country, consider whether the business has physical presence in the relevant country (i.e., historical nexus). Where there is no in-country physical presence, Amount B is not due in that particular market jurisdiction.

<sup>4</sup> See OECD, Public Consultation Document, *Secretariat Proposal for a “Unified Approach” under Pillar One*; OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors (October 2019).

### Potential impact on customs valuation

Much work has been done in the past decade to better align income tax transfer pricing and customs valuation rules. Multinational businesses, as a rule, set transfer prices to meet income tax requirements and want to use those transfer prices for both income tax and customs reporting. The World Customs Organization, an intergovernmental organization representing 180 customs administrations, and the OECD jointly sponsored conferences to explore convergence of transfer pricing and customs valuation rules in 2006 and 2007, and established a focus group in 2008 to suggest approaches. Following the focus group recommendation, the World Trade Organization (WTO) Technical Committee on Customs Valuation adopted Commentary 23.1, which recognizes the use of transfer pricing studies in applying customs valuation rules, and Case Studies 14.1 and 14.2 providing specific guidance. The World Customs Organization has also issued a Guide to Customs Valuation and Transfer Pricing.

The extent to which the Pillar 1 proposal could impact transfer pricing on tangible goods depends both on the scope, and application of the rules. For example, if the scope of “consumer-facing businesses” is limited to cross-border business-to-consumer (B2C) transactions, the impact on customs valuation is likely minimal, as a cross-border B2C sale would typically be valued for customs purposes at the price the consumer pays for the goods.

If, however, business-to-business (B2B) transactions are in scope, the manner of allocating and payment of Amount A liabilities could have a direct impact on customs valuation. A B2B import of a tangible product for a consumer facing business, for example, would include a sale from a product manufacturer to a related-party importer, who would then sell to consumers. If the Amount A liability is borne by the importer, it is unclear whether or not the Amount A liability would change the transfer price of the product. If it did, the transfer price for products imported during the year would presumably be reduced by the Amount A liability. A customs authority may consider a price reduced by a formula imposed for income taxes to be a price “influenced by the relationship of the parties” (not an arm’s-length price) ineligible for transaction value, and consequently requiring a different customs value than the transfer price. If B2B transactions are in scope, there may be other mechanisms allowing the transfer price to remain intact, for example, by separating the Amount A tax obligation from that of in-country operations. Both scope and application detail must be further defined to assess impact.

And while the impact on tangible products currently subject to duty could be notable, there is also the potential for digital transmissions themselves to become subject to customs duties if the WTO moratorium on electronic transmissions is not further extended or made permanent in June 2020. See [WTO moratorium on electronic transmissions continues](#) on page 11 in this issue of *TradeWatch*.

Public comments filed on Pillar 1, including comments filed by the WCO and the International Chamber of Commerce, did highlight the importance of considering customs valuation as part of further development.

### Actions for business

In the current disruptive trade environment, businesses are increasingly considering the impact of new trade developments on other aspects of the business and jointly planning for tax and customs consequences. The detailed development of Pillar 1 provides another development, this time tax generated, that requires consideration of both tax and customs implications. Multinational businesses will want to encourage the OECD to involve customs experts in further developing proposals and carefully monitor and provide input on customs aspects in conjunction with their own ongoing tax input. ■

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# Free trade agreement between the EU and Singapore enters into force

On 8 November 2019, the EU Council approved the Free Trade Agreement (FTA) between the EU and Singapore (EUSFTA).<sup>1</sup> Both parties announced that the EUSFTA would enter into force as of 21 November 2019. With the EUSFTA in place, more than 80% of EU customs duties are removed for imports of goods with Singapore preferential origin. Vice versa, Singapore has removed all customs duties upon entry into force. For the rest, EU tariffs will be removed within three or five years, depending on the product category. Also, the EUSFTA will enable EU access to some highly regulated Singaporean markets.

In this article we go into more detail on the upcoming application of this new EU FTA.

## Key elements of the FTA

### Trade in goods

The EU-Singapore FTA is mostly aimed at duty free trade.<sup>2</sup> Singapore has removed all remaining tariffs on certain EU products (like alcoholic beverages, including beer and stout) and commits to keep unchanged the current duty-free access for all other EU products. Upon import into the EU of goods with Singapore preferential origin, sectors that benefit from the immediate removal of tariffs are electronics, pharmaceuticals, petrochemicals and processed agricultural products. Tariffs on certain types of textiles and carpets will be dismantled over three years; tariffs on bikes, fruits, cereals and sports footwear will be removed over five years.

The EU-Singapore EUSFTA foresees further facilitating regional cumulation in a wider range of products once the EU has concluded additional trade agreements with other ASEAN Member States.

### Trade in services

The EUSFTA provides access to a wide range of service fields, including telecommunications, environmental, financial, engineering, computing and maritime transport services.

The trade agreement also presents new opportunities for firms wanting to establish a commercial presence, by improving market access in services and many non-services sectors such as manufacturing. This means, for instance, new opportunities to attract investment for industrial production.

### Removal of regulatory barriers

Non-tariff barriers are addressed by the EUSFTA as well, which facilitates the access of EU companies to the highly regulated Singaporean market and vice versa. These non-tariff barriers concern, among others, electronics, motor vehicles and vehicle parts, pharmaceuticals and medical services (particularly those developed by international standard setting bodies), equipment for renewable energy generation, raw and processed products of animal and plant origin, etc. The EUSFTA enhances customs cooperation to simplify, harmonize, standardize, and

<sup>1</sup> The EU and Singapore have also concluded an investment protection agreement, which can enter into force after it has been ratified by all EU Member States according to their own national procedures. At this moment it is not yet known when this will enter into force.  
<sup>2</sup> Please note that the EU and Singapore have also concluded the negotiation of a soon-to-be-signed Partnership and Cooperation Agreement, which will provide a further and more comprehensive legal framework between the EU and Singapore.

modernize trade procedures so as to cut transaction costs for businesses. The agreement includes steps toward the mutual recognition of the EU's AEO.

Beyond removal of customs duties and non-tariff barriers for trade in goods and services, the agreement contains important provisions on intellectual property protection, investment liberalization, public procurement, competition and sustainable development.

### **Simplified procedures for proving preferential origin**

The EUSFTA provides reciprocal and mutually advantageous benefits for companies involved in supply chains between the EU and Singapore. To make use of these benefits – e.g., elimination of tariffs on goods – certain conditions should be fulfilled:

1. Goods shipped between the EU and Singapore should have obtained preferential origin "Singapore" or "EU."
2. The goods may not have been altered, transformed in any way or subjected to operations other than operations to preserve them in good condition or other than adding or affixing marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements of the importing party, prior to being declared for import. The storage of products or consignments may take place, provided they remain under customs supervision in the country(ies) of transit.
3. The goods must be accompanied by an origin declaration made out by the exporter.

An origin declaration can be printed on an invoice or other commercial document and can apply to a single or to multiple shipments (which is valid for 12 months). It demonstrates that the product is originating or that the materials used in production are originating.

### **ASEAN cumulation**

The agreements with Singapore are regarded as a good reference point for the other trade and investment agreements the EU is negotiating with ASEAN Member States. Since launching negotiations with Singapore in March 2010, the EU has also started bilateral talks with Malaysia (2010), Vietnam (2012), Thailand (2013), the Philippines (2015) and Indonesia (2016). Anticipating future FTAs to be concluded with other ASEAN countries, the EUSFTA incorporates the concept of "ASEAN cumulation" for Singapore's key exports to the EU. This allows Singapore manufacturers to include the use of raw materials and parts sourced from ASEAN Member States as originating content when determining whether their exports can meet the required rules on origin. This possibility can be applied on raw materials and parts originating in ASEAN countries with which the EU has concluded EUSFTAs. It will therefore become relevant as soon as FTAs are concluded with other ASEAN countries.

The EUSFTA also marks the first bilateral FTA where Asian food products (whereby it is not required that all ingredients used were grown/produced in Singapore) made in Singapore can enter the EU tariff free under liberal rules on origin, up to a combined quota of 1,250 tonnes annually.

### **Prepare to benefit**

Benefitting from the preferential duty treatment essentially comes down to bringing into line your origin management with the conditions stated in the EUSFTA.

Actions for businesses include:

- ▶ Assessing whether your goods subject to export from the EU to Singapore or vice versa have obtained preferential origin
- ▶ Mapping and visualizing the exported products to Singapore/imported from Singapore by using customs analytics, to calculate all potential duty savings under the EUSFTA
- ▶ Identifying the different stakeholders for origin management in your current supply chain set-up, especially with regard to identifying the exporter required to print the origin statements
- ▶ Helping with the application as registered exporter
- ▶ Helping you optimize your supply chain enabling you to make use of EU-Singapore EUSFTA (or other free trade agreements) by identifying potential opportunities for simplifications and standardization and set-out a road map to implement these optimizations. ■

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# How is trade policy disrupting global trade?

Trade measures introduced by the United States, the European Union, China and other jurisdictions in recent months are having a significant and disruptive impact on global trade. This is a fast-moving

area, involving constant change – but companies operating in affected jurisdictions and industries must keep abreast of these crucial developments.

**Read more on this issue in the**  
[Global Trade Disruptors magazine.](#) ■

# International Chamber of Commerce launches Incoterms® 2020

With globalization and industrialization, companies today are trading more than ever before to reduce costs, optimize taxes and maximize profits. If a company supplies goods to another, it becomes imperative for the involved companies to identify who is responsible for the transportation of the goods and when such liability is triggered. Does the responsibility of the seller end when the goods are

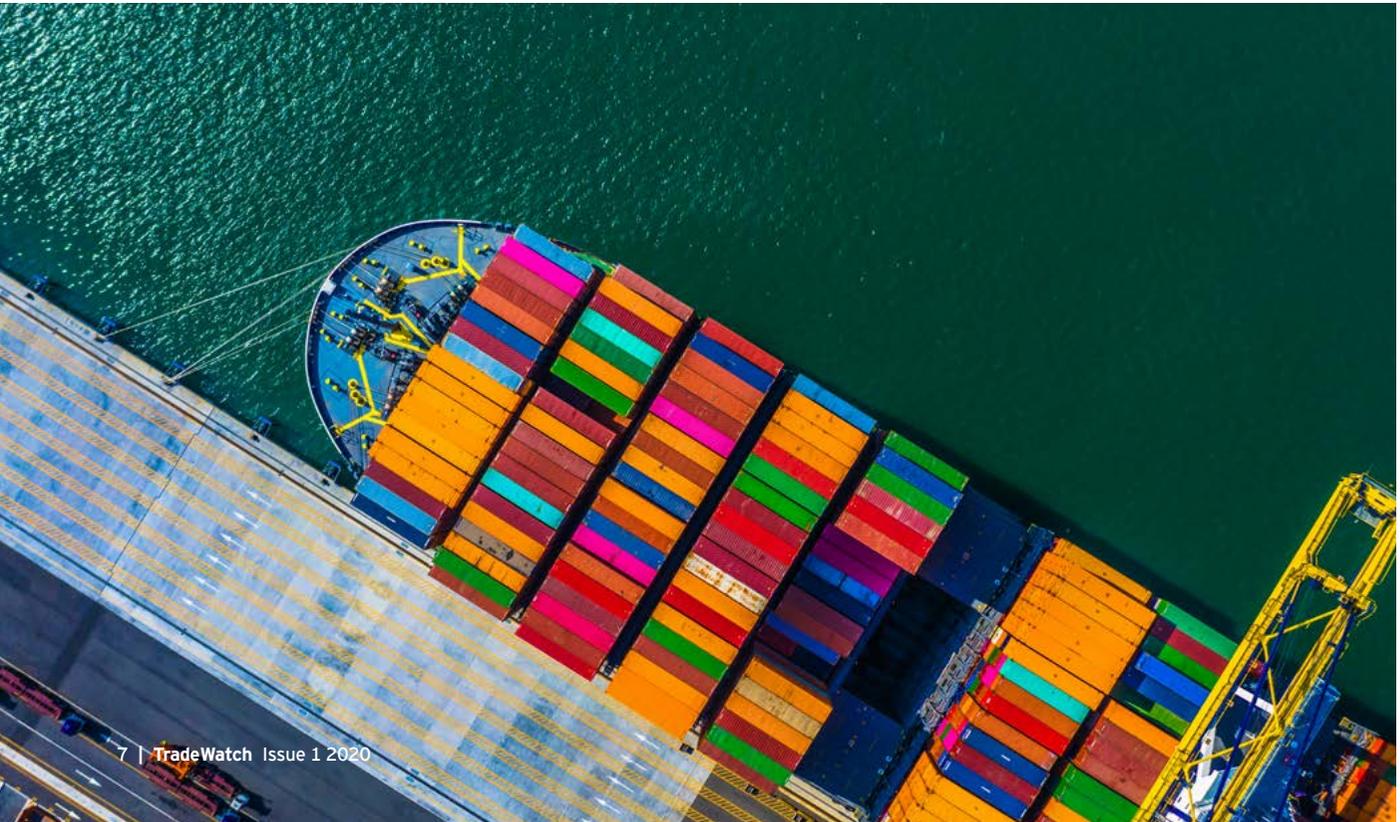
placed on board a vessel? Or does it cease instead at the factory gate of the seller? The Incoterms® rules seek to provide unambiguous guidance as to obligations, risks and costs of the parties. The release of the new Incoterms® 2020 edition on 10 September 2019 by the International Chamber of Commerce (ICC) seeks to reduce uncertainties and provide additional clarifications in various scenarios.

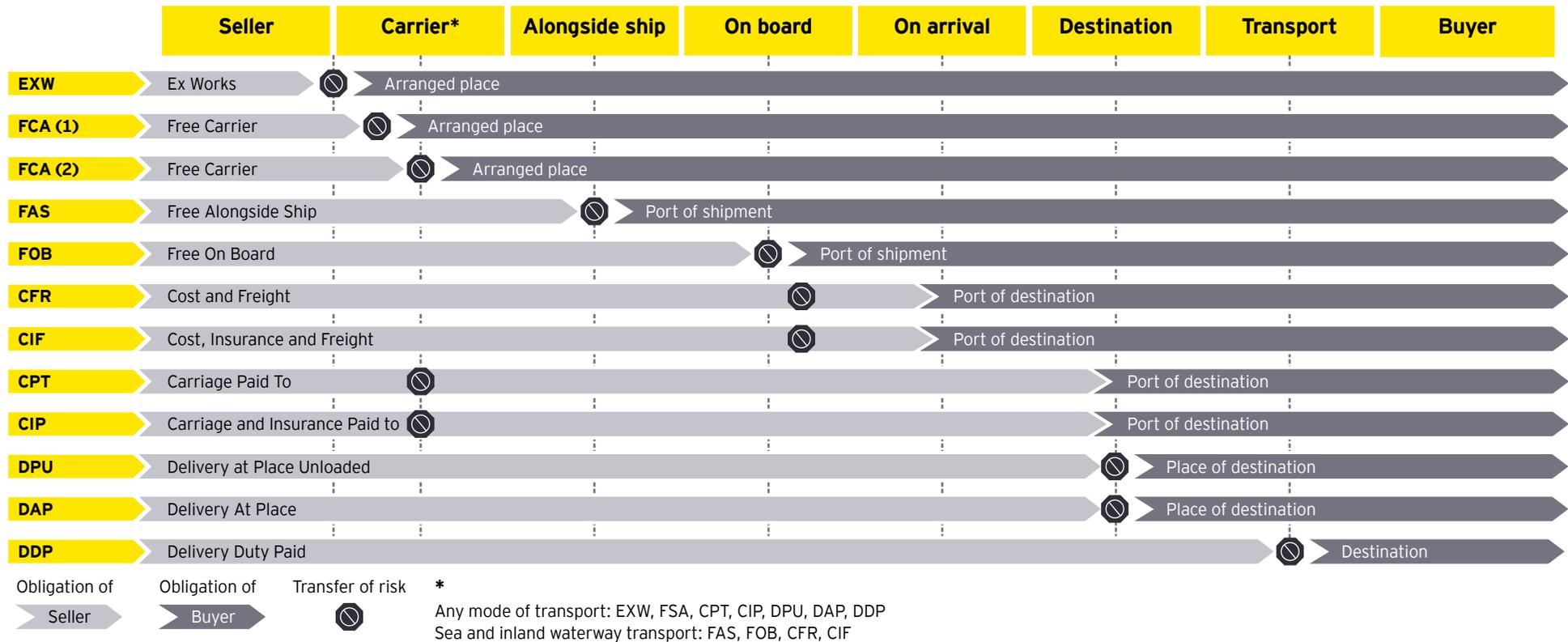
This contribution summarizes the modification to the Incoterms® rules and provides an overview of the legal, global trade and customs, indirect tax, operational model and effectiveness (OME) and information technology (IT) consequences that arise from the launch of the Incoterms® 2020.

## Launch of the Incoterms® 2020 – modifications and legal aspects

The Incoterms® 2020 edition introduces new terms and removes and modifies existing terms.<sup>1</sup> The figure below illustrates if it is either the obligation of the buyer or seller to arrange the transport of the goods and clearly shows how the risks and costs are divided between the seller and buyer under the Incoterms® 2020 edition.

<sup>1</sup> List of Incoterms® 2020 (alpha order)  
CFR | Cost and freight  
CIF | Cost insurance and freight  
CIP | Carriage and insurance paid to  
CPT | Carriage paid to  
DAP | Delivered at place  
DDP | Delivered duty paid  
DPU | Delivered at place unloaded  
EXW | Ex works  
FAS | Free alongside ship  
FCA | Free carrier  
FOB | Free on board





The Incoterms® 2020 edition applies as from 1 January 2020. Users can still use the Incoterms® 2010 edition (or earlier editions), however, the new Incoterms® 2020 rules are more tailored to current market practice and can therefore be more useful to the business. However, it is necessary to be unambiguous in which version of the Incoterms® is being used (i.e., include the year of the version used after "Incoterms®").

The most important changes to the Incoterms® are:

- ▶ **FCA:** the new rule now provides for an additional option, namely that the parties can agree that the buyer must instruct the carrier to issue to the seller, at the buyer's cost and risk, a transport document stating that the goods have been loaded if this is agreed, the seller is obligated to provide such transaction document to buyer.

- ▶ **Different levels of insurance cover in CIF and CIP by default:** in the Incoterms® 2010 edition, CIF and CIP had a standard minimum level of insurance, if not agreed otherwise by the parties. For CIF and CIP a different minimum insurance cover applies under the Incoterms® 2020 edition.
- ▶ **DAT has been changed to DPU:** DAT is renamed to DPU to emphasize that the place of destination could be any place and not only a terminal. If the



place to deliver the goods is not a terminal, the seller must make sure that the place where it intends to deliver the goods is a place where it is able to unload the goods.

- ▶ **Arranging for carriage by means of own transport under the FCA, DAP, DPU (former DAT) and DDP rules are now explicitly included.** The Incoterms® 2010 rules, however, assumed that a third-party carrier would carry the goods, however, in practice a buyer or seller would also arrange the transport by its own means; this practice has now been reflected in these rules.
- ▶ **A further (and clearer) allocation of security-related requirements has been included in each Incoterms® rule.** The Incoterms® rules also set out costs incurred more clearly.
- ▶ **Clearer listing of costs:** all costs related to the relevant Incoterms® rule are now listed under A9/ B9 “Allocation of costs” to provide for a one-stop list of costs.

### Incoterms® 2020 – Global Trade and Customs

From a customs perspective, the commercial terms set by the Incoterms® rules applied in a cross-border transaction are used to determine whether the seller or the buyer is responsible for the export and import formalities. It also depends on the applied Incoterms® rule as to who will bear the import duties and cost of transport, insurance and related charges. Therefore, the applied Incoterms® rule in a cross-border transaction may also play a role in determining the customs value of imported goods. Depending on whether CIF or FOB arrangements are in place in the country of importation, respectively the cost of transport, insurance and related charges up to the place of importation should or should not be part of the customs value. Costs incurred after importation (e.g., import duties and transport, insurance and related charges) should not be part of the customs value.

Except for Incoterms® 2020 rules EXW and DDP, the seller is responsible for the export formalities, whereas the buyer should take care of the import formalities. Companies using EXW and DDP may experience challenges with respect to fulfilling customs formalities as follows:

- ▶ Under EXW, the buyer is responsible for both the export and the import formalities. The buyer can, however, experience challenges while fulfilling his export formalities, especially in jurisdictions that restrict authorized exporters. According to the definition of exporter under the EU’s customs legislation, for example, the exporter should be established in the customs territory of the EU, which is often not the case for the buyer. That is typically why the Explanatory Notes to the Incoterms® 2020 edition with respect to EXW emphasize that FCA is more appropriate if the buyer intends to export the goods.
- ▶ According to the DDP Incoterms® rule, the seller is held to fulfill both the export and import formalities. The seller might be unable to do so if the importing country restricts non-resident importers or restricts VAT recovery for non-residents. To avoid the seller having to fulfill the import formalities and make sure that the place of delivery remains the place of destination, the contracting parties may opt for DAP.

Especially in these times of trade tensions, the introduction of the Incoterms® 2020 edition provides the opportunity to carefully assess the Incoterms® rules being applied in a company’s supply chain and evaluate who is responsible and liable to fulfill customs formalities and at the same time prevent over or undervaluation of the imported goods.

### Incoterms® 2020 – Indirect tax

From a value-added tax (VAT) perspective, Incoterms® are commonly used in cross-border commercial transactions and set out the responsibilities of buyers and sellers for the supply of goods under a contract. The revised Incoterms aim to provide further clarity on the tasks and costs involved in the delivery of the goods from the sellers to the buyers in a cross-border scenario. At this point, the following actions play a significant role in streamlining transactional flows and costs from a VAT perspective:

- ▶ Incorporate Incoterms® 2020 rules unambiguously into the contractual terms between buyer and seller by specifying the clear intention of seller and buyer
- ▶ Analyze use of the appropriate Incoterms® rule to set the responsibility of transport to the identified party in a cross-border EU chain transaction
- ▶ Eliminate inconsistencies in the contractual flow of goods and actual flow of goods
- ▶ Review revised Incoterms® to identify potential triggers for a VAT registration or de-registration in the destination/origin country (e.g., use of FCA/DAP instead of EXW/DDP for international deliveries)
- ▶ Revisit cost discussions with the necessary parties in a transaction to identify responsibility for costs relating to transport, packaging and loading/unloading (e.g., use of FCA for international deliveries from 2020 trigger additional costs for seller)

Operating models of global businesses include transactions between multiple parties. Incoterms® plays a critical role in identifying and allocating the obligations, risk and costs in such transactions. This could ultimately support the justification behind operating margin and tax liabilities of the parties. Some of the elements determining the choice of Incoterms® are:

- ▶ Alignment of functional and risk profile of the parties with the Incoterms
- ▶ Relationship between “title transfer” (which is not determined by Incoterms) and “delivery” as per the Incoterms
- ▶ Use of same or different Incoterms and place of delivery in a series of chain transactions to reflect risk and responsibility owned by the parties
- ▶ Allocation and recharge of cost between the parties
- ▶ Alignment of invoice value with the Incoterms to confirm which costs are already included in the invoice price

### Incoterms® 2020 – IT

ERP-supported processes are key for smooth execution of the transactional flows. Often Incoterms® rules are not aligned with the functional reality of the transactional flows and require modification. Interplay of tax, supply chain and the functional profile of the stakeholders should be correctly reflected and captured by the IT set-up. Some points of consideration are:

- ▶ Alignment of the Incoterms® 2020 rules with the transaction flows
- ▶ The Incoterms® 2020 revisions provide a chance to revisit the Incoterms used and revise the system for obsolete or nonexistent Incoterms
- ▶ The potential impact of Incoterms® rules on the tax code determination
- ▶ Alignment of Incoterms® rules for statistical reporting in the EU (e.g., Intrastat) ■

#### Listen to our podcast:

EY Global Trade Manager, Martijn Schippers, explains the impact of Incoterms® on taxes [here on LinkedIn](#).

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# WTO moratorium on electronic transmissions continues

World Trade Organization (WTO)<sup>1</sup> members have agreed to renew the prohibition of customs duties on electronic and internet transmissions, this time for only six months.<sup>2</sup> Beginning in 1995, the member countries agreed to a workplan to study the implications of electronic commerce and agreed to prohibit the assessment of customs duties while the study was undertaken. The study has never been concluded, and the WTO members have unanimously renewed an agreement to not impose customs duties on electronic and internet transmissions regularly, usually at two-year intervals. This renewal, known as the “moratorium” on customs duties, was due to expire in December 2019. On 10 December 2019, the WTO agreed to extend the moratorium until the WTO Twelfth Ministerial Conference (MC12) in Nur-Sultan, Kazakhstan, scheduled for 9-12 June 2020. The members also agreed to continue the work program started in 1995 to assist with the decision at the meeting.

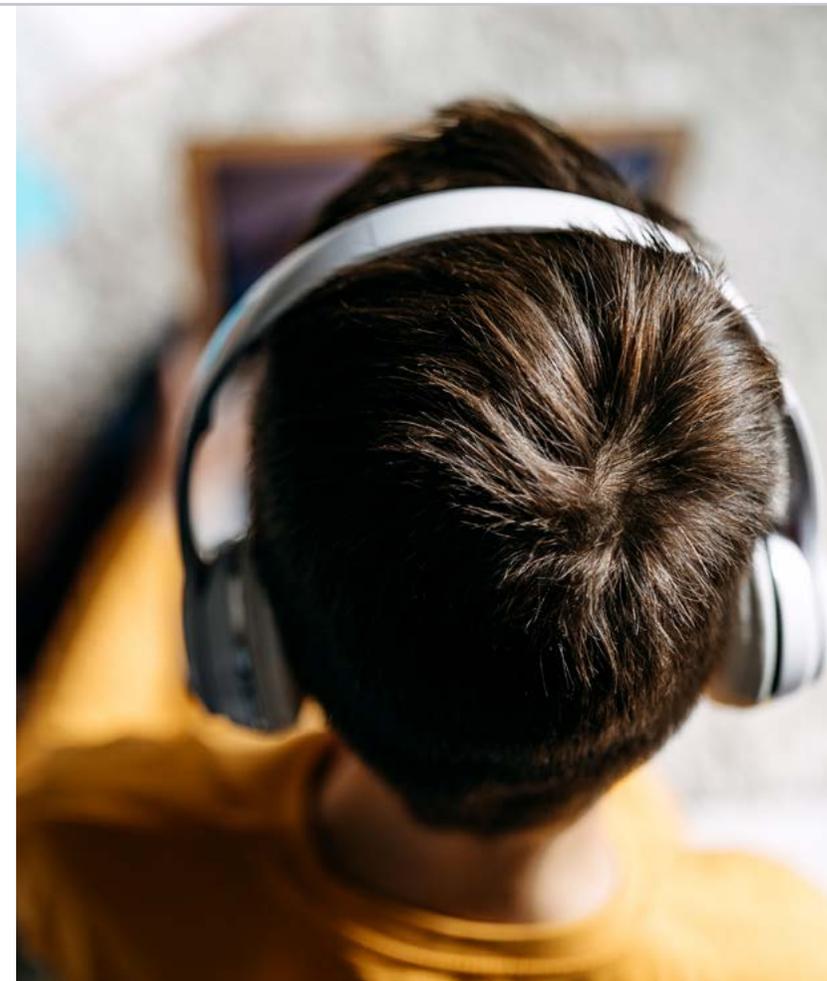
The recent renewal, while widely expected, comes at a time when several WTO-member countries, most notably India and South Africa, have expressed interest in lifting the moratorium as a way to raise

customs revenues on internet transmissions, such as e-books and music. The discussion about whether and how to impose customs duties on internet transmissions has intensified in the past year. At a WTO meeting held in April 2019, member countries were offered a forum to discuss the moratorium and the prospective implications of not renewing. One of the key questions WTO members were asked was if it is technically feasible to impose customs duties on electronic or internet transmissions. The group also evaluated how to establish reliable estimates of the value of goods that have become digital and now move across borders in international, online transactions.

With the decision for only a six-month extension, the June meeting may finally reach a conclusion on the issue – possibly making the moratorium permanent, or possibly deciding not to renew, which could leave the question of assessing duties on electronic transmissions up to each individual country. Companies that could be impacted by the assessment of duties on internet transmissions should be assessing the possible impact and expressing their views to WTO negotiators. ■

1 List of WTO member countries can be found here: [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm).

2 See WT/MIN(98)/DEC/2, 25 May 1998.



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## WTO's Appellate Body disbands

On 10 December 2019, terms for two of the three judges residing on the World Trade Organization (WTO) Appellate Body expired, leaving the Appellate Body without the requisite three arbitrators needed to preside over cases brought to the intergovernmental organization review panel. The Appellate Body, which typically consists of seven adjudicators, has gradually decreased to three after the United States (US) repeatedly exercised its veto against the appointment of new judges over the last few years.

The WTO was established on 1 January 1995 to act as an international organization to address and enforce rules and legalities of trade between nations that are members of the WTO. This role includes, but is not limited to, administering WTO trade agreements, acting as a forum for trade negotiations, monitoring national trade policies and handling trade disputes; as they pertain to the 164 WTO member countries.<sup>1</sup>

The WTO Appellate Body was established in 1995 under Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes.<sup>2</sup> Disputes are first referred to a panel of experts selected by the WTO Dispute Settlement Body in consultation with the parties to the dispute. The

panel ruling may be appealed by either party, and the Appellate Body may uphold, modify or reverse the legal findings and conclusions of a WTO panel.

The adjudicators of the Appellate Body are appointed by the Dispute Settlement Body (DSB), which is comprised of all member country governments, typically represented by ambassadors or equivalents. The Appellate Body members serve four-year terms, with the opportunity to be reappointed once. Each member country, as part of the DSB, has a vote when determining new appointees to the Appellate Body, which must be decided unanimously. The US has exercised its veto and blocked new

appointments over the last few years, leaving the WTO Appellate Body with just three members, the minimum required to review cases. Two of the three adjudicators' terms expired 10 December 2019. While cases may still be brought to a DSB panel, should a country appeal a DSB decision, the case will be stuck in limbo, unless a unanimous agreement is reached among the 164 member countries (including the parties to the dispute) on how to proceed.

The US is involved in two of the ten cases currently appealed to the Appellate Body. In the first case, the US is the complainant involving certain alleged export subsidy measures by India, where India has appealed the decision of a lower panel.<sup>3</sup> The US is the respondent in the second case, in which Canada is the complainant, regarding US anti-dumping



<sup>1</sup> List of WTO member countries can be found here: [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm).

<sup>2</sup> Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, 15 April 1994, 1867 U.N.T.S. 14, 33 I.L.M. 1143 (1994).

measures to softwood lumber products of Canada.<sup>4</sup> Canada appealed to the arbitration body due to certain issues of law and legal interpretations in the initial panel report. The US is also involved in a number of other disputes at the panel level.

The lack of a functioning Appellate Body returns countries with trade disputes to a similar environment to pre-1995 dispute resolution under the GATT. Since the Trump Administration took office, the US has been using statutes that predate the WTO to initiate trade actions, sometimes with a parallel WTO complaint and sometimes not. For instance, the Trump Administration has initiated several actions under Section 301 of the Trade Act of 1974 (Section 301), which provides the USTR the authority to levy certain measures, including tariffs, if an investigation determines the offending country imposes practices, policies or laws that are harmful to the US commerce and economy. Notable Section 301 investigations and subsequent actions include the investigation regarding China's policies and laws pertaining to technology transfers and intellectual property practices, which resulted in the US imposing punitive tariffs of 15% to 25% on US\$550<sup>5</sup> billion<sup>6</sup> of Chinese-origin goods. While the US also filed a WTO dispute on the same topic, it did not

wait to take action. In addition, the US has recently launched a Section 301 investigation pertaining to France's digital service tax (DST), which determined the tax was discriminatory against US companies and resulted in the USTR's proposal of tariffs up to 100% on certain French-origin goods, including champagne, cheeses, cosmetics and handbags.

On 17 December 2019, the US House of Representatives' Ways and Means Committee voted to approve a nonbinding resolution reaffirming the US's commitment as a member of the WTO, as well its commitment to work with other WTO members toward the improvement of the dispute settlement process.<sup>7</sup> The resolution goes on to state US support for an efficient dispute settlement mechanism at the WTO, while also noting longstanding concerns with the WTO Appellate Body. Further, the resolution highlights proposals for WTO reform, such as a more transparent dispute settlement process, including open hearings to the public. The effective suspension of the WTO Appellate Body will undoubtedly result in other countries also taking unilateral actions, similar to the US. And, when that occurs, retaliation by the targeted country may result, causing yet additional trade disruption.

WTO reform plans have been proposed. At the Eighth China Round Table on WTO Accessions in December 2019, WTO Deputy Director-General (DDG) Alan Wolff directly addressed the issue of and need for reform within the WTO, also noting that WTO reform is a contentious process.<sup>8</sup> DDG Wolff stated: "Members are exploring options for addressing the impasse over the Appellate Body. Finding a way forward on rules enforcement,

even if imperfect, will be important for preserving the integrity of the WTO system." The statement highlights that dispute settlements is at the top of most member countries' lists. DDG Wolff went on to note that while not all member countries were in support of reform initiatives, conversations would continue nonetheless, leading up to the Twelfth Ministerial Conference (MC12), which is scheduled to take place from 8-11 June 2020 in Nur-Sultan, Kazakhstan. Meaningful discussions surrounding a path forward to reforms are hoped for at the event.

Businesses are already dealing with a volatile and disruptive trade environment. With any action on the Appellate Body likely months, or potentially years away, the environmental volatility will likely increase as more countries initiate unilateral actions, prompting retaliation from others. The importance of having readily available trade data to quickly assess the consequences of actions, and potential actions, remains critical to planning in this environment. ■

3 See WT/DS541/7.

4 See WT/DS534/6.

5 All currency references in this article are to USD unless otherwise noted.

6 This figure may change in the event the US does not impose List 4B on 15 December 2019

7 House of Representatives Resolution 746 (2019).

8 See WTO press release "DDG Wolff: Acceding governments are in the vanguard of WTO reform."

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# A round-up of US trade disruption actions in 2019

Since taking office in 2016, United States (US) President Donald Trump and his administration's concerted trade agenda has had an extensive focus on addressing perceived unfair trade practices and policies by US trading partners.

The Trump administration has actively addressed perceived causes of various trade imbalances in a variety of ways, ranging from the negotiation of new bilateral and trilateral trade agreements to utilizing trade remedies that predate the World Trade Organization's (WTO) establishment<sup>1</sup>, such as Section 301 of the Trade Act of 1974 (Section 301).

## Section 301

2019 saw the continuation of actions under Section 301 by the US Trade Representative (USTR) related to China's practices and policies regarding matters such as intellectual property (IP) and forced technology transfer, as well as the initiation of new investigations, such as the investigations pertaining to subsidies provided to large civil aircraft producers by the European Union (EU).<sup>2</sup> Section 301 provides authority to impose necessary measures, including tariffs, in response to acts, policies or practices of foreign governments that either violate international trade agreements or maintain unreasonable or discriminatory trade practices that burden or restrict US commerce.

## China

The most notable Section 301 investigation began in August 2017, when the USTR launched an investigation into whether China's laws, policies or practices were damaging to American IP rights, innovation and technology developments.<sup>3</sup> The findings, announced in March 2018, found that China's laws and policies did inflict harm on US commerce and that the US was therefore entitled to take action to confront the issues laid out in the report.<sup>4</sup>

The USTR subsequently proposed 25% punitive duties on US\$34b worth of Chinese-origin goods (List 1).<sup>5</sup> China responded accordingly with initial reactive duties of 25% on US\$34b worth of US-origin goods. These actions set off incremental, broad additional duty impositions by both countries while intermittent rounds of negotiations took place. The US, and subsequently China, implemented processes for importers to seek exclusion of the punitive tariffs under certain circumstances, adding further complexity and uncertainty to the total business impact triggered by the punitive duties. The full range of actions taken by the US are further illustrated on the next page.

<sup>1</sup> WTO Agreement: Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994).

<sup>2</sup> See 84 FR 15028.

<sup>3</sup> See 82 FR 39007.

<sup>4</sup> See USTR report, "Findings of the Investigation into China's Acts, Policies, and Practices, Related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974, Executive Summary".

<sup>5</sup> See 83 FR 28710.

List	US\$ amount	Affected product categories	Duty rate	Exclusions requested/granted	Comments	
1	US\$34b <sup>6</sup>	<ul style="list-style-type: none"> <li>▶ Rubber/rubber articles</li> <li>▶ Nuclear reactors and boilers</li> <li>▶ Electrical machinery</li> </ul>	<ul style="list-style-type: none"> <li>▶ Certain vehicles</li> <li>▶ Aircraft and spacecraft/components</li> <li>▶ Medical and surgical instruments</li> </ul>	25%	3,657 of 10,814 (33.8%)	
2	US\$16b <sup>7</sup>	<ul style="list-style-type: none"> <li>▶ Mineral fuels/oils</li> <li>▶ Miscellaneous chemical articles</li> <li>▶ Plastics and plastic articles</li> <li>▶ Glass and glassware</li> </ul>	<ul style="list-style-type: none"> <li>▶ Articles of iron or steel</li> <li>▶ Aluminum and aluminum articles</li> <li>▶ Nuclear reactors</li> <li>▶ Boilers</li> </ul>	25%	1,074 of 2,869 (37.4%)	
3	US\$200b <sup>8</sup>	<ul style="list-style-type: none"> <li>▶ Organic chemicals</li> <li>▶ Inorganic chemicals</li> <li>▶ Cotton</li> <li>▶ Paper and paperboard</li> </ul>	<ul style="list-style-type: none"> <li>▶ Electrical machinery</li> <li>▶ Wood articles</li> <li>▶ Certain vegetables</li> </ul>	25%	396 of 12,602 (3.1%)	17,683 exclusion requests still pending
4A	US\$115b <sup>9</sup>	<ul style="list-style-type: none"> <li>▶ Flat panel TV sets</li> <li>▶ Flash memory devices</li> <li>▶ Power tools</li> <li>▶ Cotton sweaters</li> </ul>	<ul style="list-style-type: none"> <li>▶ Bed linens</li> <li>▶ Multifunctional printers</li> <li>▶ Footwear</li> </ul>	7.5%*	1,596 requests as of 1/16/2020	*Rates reduced from 15% to 7.5% on February 14, 2020 with the implementation of the Phase One agreement <sup>10</sup>
4B	US\$134b <sup>11</sup>	<ul style="list-style-type: none"> <li>▶ Cell phones</li> <li>▶ Laptops</li> <li>▶ Video game consoles</li> </ul>	<ul style="list-style-type: none"> <li>▶ Certain toys</li> <li>▶ Computer monitors</li> <li>▶ Certain footwear and clothing items</li> </ul>	N/A		Implementation of List 4B indefinitely suspended <sup>12</sup>

<sup>6</sup> See footnote 5

<sup>7</sup> See 83 FR 40823.

<sup>8</sup> See 83 FR 26930.

<sup>9</sup> See 84 FR 45821.

<sup>10</sup> See 85 FR 3741.

<sup>11</sup> See footnote 8.

<sup>12</sup> See 84 FR 69447.

The fourth quarter of 2019 saw the beginning of a reprieve or “truce” of trade tensions, culminating with the signing of the Phase One Economic and Trade Agreement (Agreement or Phase One) between the US and China on 15 January 2020.

The 96-page agreement ultimately included a preamble and seven chapters on specific provisions<sup>13</sup>:

- ▶ Intellectual property (IP)
- ▶ Technology transfer
- ▶ Agriculture
- ▶ Financial services
- ▶ Macroeconomic policies and exchange rate matters (currency)
- ▶ Expanding trade and dispute resolution

The administration has stated that these chapters address what are seen as several key discriminatory and harmful policies conducted by China as provided in the initial Section 301 report, but others remain unresolved.

Signing of the Phase One Agreement brings a halt to the cycle of escalating tariff increases and provides a framework for a continued, multifaceted process of ensuing negotiations. Phase One includes concessions by both nations to restore the balance of trade, such as Chinese buying commitments in many sectors, including manufacturing, agricultural, energy and services, as well as the cancellation of US List 4B tariffs; however, outstanding and complex items remain to be addressed in future negotiations.



The US administration has indicated there remains outstanding areas of concern as far as it is concerned and it expects these issues to be addressed in further negotiations (e.g., Phase Two or additional phases). The parties have agreed to form a Trade Framework Group with a mandate to address the outstanding areas of concern. Most notably, the outstanding areas include:

- ▶ Information and communications technology policies
- ▶ Subsidies
- ▶ State-owned enterprise disciplines
- ▶ Cyber intrusions

- ▶ Anti-monopoly law enforcement
- ▶ Services to include data localization, cloud computing and express delivery

Further, while the Phase One Agreement addresses many non-tariff barriers to entry for US companies, as well as longstanding concerns about doing business within China, it does not address the current tariffs that remain on both the majority of Chinese-origin goods imported into the US and those imposed on a significant amount of US-origin goods imported into China.

<sup>13</sup> See “Economic and Trade Agreement between the Government of the United States of America and the Government of the People’s Republic of China.”

### European Union

In April 2019, the USTR initiated a Section 301 investigation regarding the enforcement of US rights in their WTO dispute against the European Union (EU) and specific EU Member States<sup>14</sup>, which addressed EU subsidies on large civil aircrafts. The US had long held the opinion that EU Member States, specifically France, Germany, Spain and the United Kingdom (UK), have unfairly subsidized non-US aircraft manufacturers to an extent that was damaging to the US and its economy.

The WTO had determined that assistance provided to non-US aircraft manufacturers was inconsistent with the EU's obligations under the General Agreement on Tariffs and Trade (GATT). The EU subsequently moved to adjust some subsidies provided; however, in May 2018, the WTO concluded there were additional violations. This result permitted the EU to initiate the process to seek countermeasures.

In October 2019, the WTO Arbitrator issued its report regarding the appropriate value of acceptable countermeasures that the US could impose on the EU for providing subsidies to non-US aircraft manufacturers. The WTO arbitrators determined that the US was entitled to impose tariffs on US\$7.5 billion of EU-origin goods.<sup>15</sup>

Following the WTO decision, the USTR published a final product list with 15 different sections covering 160 different eight-digit Harmonized Tariff Schedule of the US (HTSUS) codes.<sup>16</sup> Certain aircrafts from specified EU countries are subject to a 10% *ad valorem* duty rate, and other products are subject to a 25% duty rate. All 15 sections went into effect on 18 October 2019.

On 6 December 2019, the USTR published a notice containing two Annexes and requesting public comment. Annex I contained a list of EU-origin products currently subject to punitive duties of 10% and proposed to increase to 25%, and Annex II contained a list of new products consisting of 365 tariff headings, broken into 16 sections.

The EU has indicated they are working toward a resolution with the US in the hope that the additional punitive tariffs do not take effect.

### France

The US has also utilized Section 301 investigations as a tool to address perceived discriminatory practices outside of the trade space. For example, in July 2019, the USTR commenced an investigation into the French Digital Service Tax (DST). The tax, signed into law on 24 July 2019, consists of a 3% levy on global revenues generated by “digital interface” services provided to French users. The tax is retroactive to 1 January 2019 and applies to companies that have global annual revenues in excess of €750 million, or US\$845 million at the current exchange rate, and that have €25 million, or US\$28.15 million, of digital sales that are generated in France. The tax is estimated to impact 30

companies, which includes one French company, and it is expected to raise approximately €500 million.

The USTR released the report and findings of its investigation on 2 December 2019.<sup>17</sup> The report stated that the DST creates a burden on US commerce due to five primary findings, namely that the tax was discriminatory against US digital companies and applications of the tax were inconsistent with prevailing international tax principles.

On this basis, the USTR proposed countermeasures in the form of tariffs of up to 100% on French-origin goods, preliminarily covering 63 tariff subheadings, with items such as cheeses, champagne, cosmetics, handbags and porcelain, with an estimated value of approximately US\$2.4 billion of import value.

In mid-January 2020, President Emmanuel Macron announced that France would postpone the collection of the DST payments until December 2020, with the US agreeing to delay imposition of the proposed tariffs, as conversations surrounding DSTs and taxation of the digital economy continued at the Organisation for Economic Co-operation and Development (OECD). At time of publication, the US has not released an official statement to this effect.

### Looking ahead

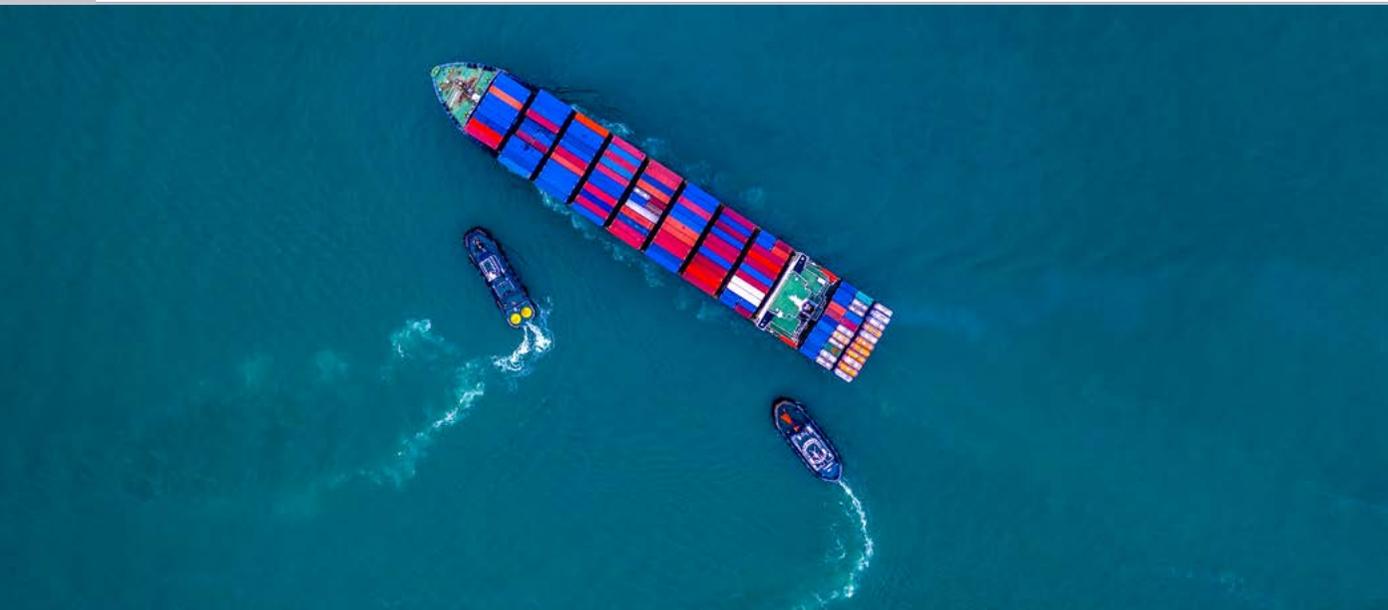
It should be noted that the USTR has indicated it is exploring whether or not to open investigations into the DSTs of other nations, namely Austria, Italy and Turkey, and as the USTR is “focused on countering the growing protectionism of EU Member States, which unfairly targets US companies, whether

<sup>14</sup> EU member countries are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

<sup>15</sup> See WTO Dispute Number WT/DS316/ARB.

<sup>16</sup> See 84 FR 55998.

<sup>17</sup> [https://ustr.gov/sites/default/files/Notice\\_of\\_Determination\\_and\\_Request\\_for\\_Comments\\_Concerning\\_Action\\_Pursuant\\_to\\_Section\\_301\\_France%E2%80%99s\\_Digital\\_Services\\_Tax.pdf](https://ustr.gov/sites/default/files/Notice_of_Determination_and_Request_for_Comments_Concerning_Action_Pursuant_to_Section_301_France%E2%80%99s_Digital_Services_Tax.pdf)



through digital services taxes or other efforts that target leading US digital services companies.”<sup>18</sup> This sentiment may be the start of further investigations that highlight how trade in goods and trade in services are beginning to intermingle.

For more discussion on taxation in the digital space and its implication on global trade, see [Customs valuation impact of the OECD/G20 BEPS project](#) and [WTO moratorium on electronic transmissions continues](#) articles in this edition of *TradeWatch*.

### Trade agreements

While the current US Administration has taken many actions in addressing perceived trade imbalances in the form of punitive tariffs, they have also signed new trade agreements.

President Trump and his administration have made clear that they favor bilateral agreements over multilateral agreements, as illustrated by the US withdrawal from the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP) and the beginning of separate negotiations with Japan and other nations that subsequently followed.

### USMCA

One of President Trump's presidential campaign promises was to renegotiate the North American Free Trade Agreement (NAFTA), which he viewed as an unfavorable deal for the US. NAFTA, which includes US, Mexico and Canada as signatory countries, entered into force on 1 January 1994 and created one of the world's largest free-trade areas.

Renegotiations of the Agreement began in August 2017, with all three countries in agreement that modernization of the nearly 25-year-old text were warranted. However, as further detailed in our [Summer 2019 issue of TradeWatch](#), each country had different objectives when coming to the negotiating table.

The Mexican Senate ultimately ratified the concluded Agreement, reached after several negotiations and hurdles, with a two-thirds majority on 19 June 2019.

In Canada, the bill was not passed during the last Parliamentary session in 2019. Canada's new Parliament will now need to consider the Agreement and vote on its passage. The Parliamentary session began in mid-January, and the necessary legislation was introduced for USMCA passage on 29 January 2020.

The Agreement also faced much controversy in the US House of Representatives, which has a Democratic majority. Specifically, there were concerns around key provisions related to labor, environment, enforcement and biologics.

After further negotiations with Canada and Mexico, which were necessary to address US legislator opposition, the Agreement was amended by a Protocol to the Amendments, which addressed many of the House of Representative concerns. Subsequently, the agreement passed in the House of Representatives on 19 December 2019 and then by the US Senate on 16 January 2020. President Trump signed the Agreement into law on 29 January 2020.

<sup>18</sup> See USTR press release, Conclusion of USTR's Investigation Under Section 301 into France's Digital Services Tax.

USMCA cannot enter into effect until 90 days after all the parties have approved the Agreement. Parties will also have to certify that all parties have implemented the necessary changes to their domestic laws and regulations for the Agreement to enter into force. This period will also include publication of relevant new regulations.

### US-Japan

In 2018, President Trump and Japanese Prime Minister Shinzo Abe announced their intent to begin negotiations on a US-Japan bilateral trade deal.

Negotiations between the US and Japan began in April 2019, with President Trump and Prime Minister Abe announcing the Agreements' completion at the United Nations General Assembly in New York City in late September 2019.

On 26 December 2019, President Trump signed a proclamation implementing two separate trade deals with Japan (collectively, the Agreements),<sup>19</sup> following the approval of the Agreements by Japan's bicameral legislature, the National Diet, earlier that same month. The US-Japan Trade Agreement will eliminate or reduce duty rates on agricultural and industrial goods and establish preferential quotas for US-specific goods. The US-Japan Digital Trade Agreement (Digital Trade Agreement) is a separate agreement between the two countries that will provide guidelines on priority areas of digital trade.

<sup>19</sup> Proclamation 9974 of December 26, 2019 To Take Certain Actions Under the African Growth and Opportunity Act and for Other Purposes, 84 Fed. Reg. 72187 (Dec. 30, 2019).

<sup>20</sup> <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/ambassador-lichtizer-lauds-japan#>.

The Agreements went into effect on 1 January 2020 and are expected to be the foundation for further negotiations of a broader free trade agreement between the US and Japan.<sup>20</sup>

The Digital Trade Agreement is a separate agreement that establishes rules in the digital space. Notable provisions include the prohibition of customs duties on electronically submitted content (e.g., software and music) and the recognition of an electronic signature as a legally appropriate means of authentication. This is an important provision, as the WTO Moratorium on electronic transfers is up for renewal at the 12th Ministerial Conference in June 2020 (see [WTO moratorium on electronic transmissions continues](#) article in this issue of *TradeWatch*).

Within four months of implementation, President Trump and Prime Minister Abe will shift their efforts toward securing a more comprehensive trade deal. This broader agreement is expected to cover both tariff and non-tariff barriers to trade, including customs duties and restrictions on the trade of services and investment.

### Actions for businesses

As the trade disruption continues, it is critical that companies understand the impact of trade policy on their supply chain. This may include the impact of Section 301 actions, as well as free trade agreements (such as USMCA and US-Japan). Mapping the supply chain is key in every scenario and understanding how to either mitigate a negative impact or take advantage of a positive benefit is crucial.

An area of particular importance when discussing Section 301 duties is transfer pricing, as US distributors who purchase from related parties will almost certainly have transfer prices impacted. Along with the strategic importance of mitigating duty impacts while aligning the income tax and customs approaches, mechanics for reporting any transfer pricing adjustments to US Customs should also be reviewed. This process may be particularly complex when duties are present for only a portion of the year, and in many cases, actions need to be taken in advance of importations.

US Customs has very specific rules for reporting adjustments to prices made after importation, such as transfer pricing adjustments. These rules require that the importer take specific actions before importation of goods for which prices may be adjusted, including adding customs-specific language to transfer pricing policies. Importers are well advised to address these requirements prior to the imposition of these duties to ensure leading practice compliance. ■

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## Actions taken by Ecuadorian authorities to promote global trade

**Can emulating trade and economic policies from other parts of the world help poorer countries grow their economies? In this article we consider actions being taken in Ecuador to learn from the successes of the “Asian Tigers” to promote global trade.**

### The Asian Tigers

Hong Kong, Taiwan, Singapore and South Korea are the so-called Asian Tigers: the four economies of Southeast Asia that grew at the fastest rates since the 1960s. These economies are often used as a case study in the fields of economic growth and international trade. Why?

- ▶ Up to the 1960s around 90% of their exported products were agricultural goods with low added value, almost 75% of their labor force had less than a secondary education and their investment rates were no more than 10%, with Hong Kong being an exception (which had 30%).

- ▶ After this decade, their per capita gross domestic product (GDP) started to grow at unprecedented rates. In a study sample<sup>1</sup> of 113 economies for the period from 1960 to 2000, the group's average growth rate was 1.8%, ranging from the lowest rate of 3.4% (Democratic Republic of Congo) to the highest rate 6.4% (Taiwan). On average, the per capita GDP growth rate was 6% for the Asian Tigers. Here are two examples of this spectacular growth: the per capita GDP of Taiwan and Singapore in 1960 was USD1,430 and USD2,160, respectively, but they were USD18,700 and USD26,100 respectively four decades later.
- ▶ According to neoclassical growth theory<sup>2</sup> these economies should have shown a deceleration of their economies because they were increasing their investment rates. It is believed the main reason for their fast growth was capital accumulation, not only physical capital but also human capital. By 1990, more than 70%<sup>3</sup> of the working population had at least a secondary education, reversing the statistics of 1960. These are still growing economies with a high per capita income, whose export offer is no longer agricultural goods, but high added-value manufactured products.

1 Sala-i-Martin, Xavier (2003). "The World Distribution of Income, 1970-2000." Unpublished, Columbia University.

2 Solow, Robert M. (1956). "A contribution to the Theory of Economic Growth" Quarterly Journal of Economics, 70, February, 65-94.

3 Solow, Robert M. (1956). "A contribution to the Theory of Economic Growth" Quarterly Journal of Economics, 70, February, 65-94.

### Ecuador's economic reform

Consensus in the economic literature<sup>4</sup> is that the main reason for the rapid growth of the Asian Tigers' economies was trade. Other countries around the world have tried to apply the same recipe to their economies aiming for similar results. One such country is Ecuador, a small, poor but beautiful country on the Pacific Ocean coast of South America.

In 2012, Ecuador started planning a major structural change in its economy. The government developed a "change in the production matrix," which consisted of turning the country's exporting pattern of agricultural and petroleum production into a higher added value offering. With respect to international trade, this initiative had two main pillars: export promotion and selective import substitution, just as was done in the Asian Tiger economies.

Ecuador then started increasing trade barriers to protect the fledgling industries selected for the plan. Tariffs were increased up to the maximum tariff set by the World Trade Organization (WTO) in each category of selected products. However, the chosen industries were not always selected based on appropriate criteria. For example, it might be utopian to think that a country with low income, a low endowment of high-skilled labor and low resources to invest in research and development could, for example, discover new active ingredients for pharmaceuticals, such as those produced by the United States and Germany which have more than 200 years' experience in this industry. Plus, increased tariff barriers caused distortions in Ecuadorian society.

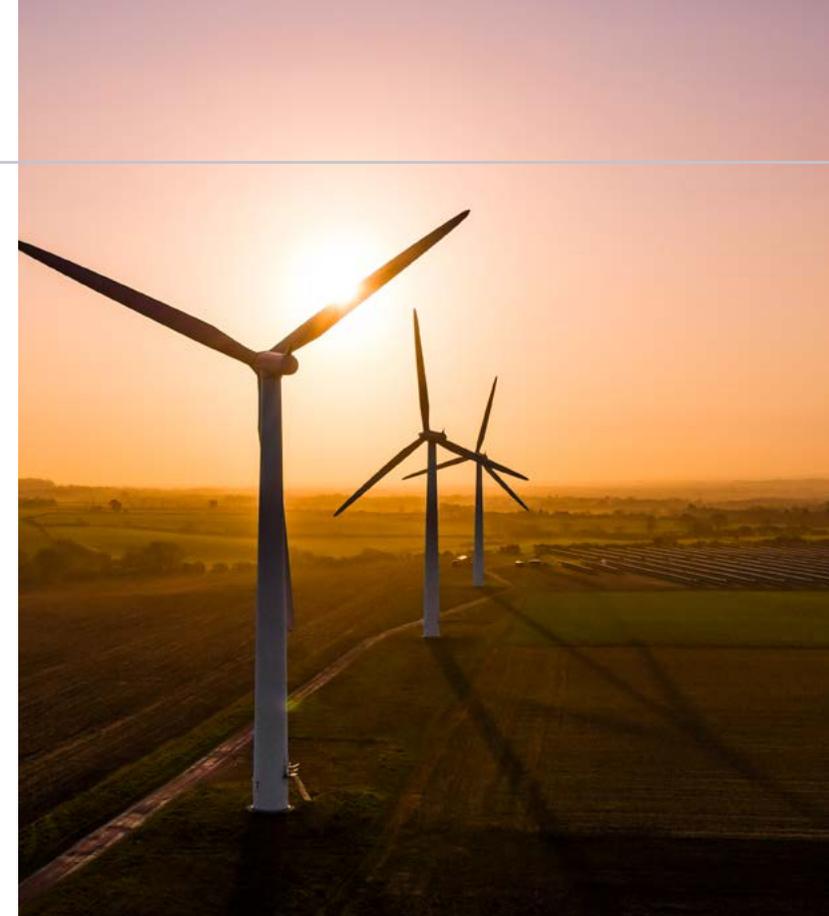
### Selected priority sectors for the Ecuadorian economy

Goods	Services
Fresh and processed foods	Environmental services
Clothing and footwear	Technology
Biotechnology	Vehicles
Renewable energy	Construction
Pharmaceuticals	Tourism
Metalworking	Transportation and logistics activities
Petrochemical	
Wood and forest products	

Source: Planning and Development National Secretariat of Ecuador (SENPLADES)

Unlike in the case of the Asian Tigers, the incentives to promote the selected fledgling industries were lacking: South Korea, for example, set productivity measures to control the protected firms and to keep awarding them with support-like subsidies. In Ecuador, none of these measures have been taken. Local producers know they will have tariff protection from external competitors, and so the motivation to improve production and make it more competitive does not exist.

In 2016, Ecuador made an important move toward free trade and an alliance with the private sector to boost investment and growth. A Free Trade Agreement (FTA) was signed with the EU, excluding sensitive products (such as some dairy items). This FTA has been positive for the Ecuadorian economy because the EU is one of the main destinations for Ecuadorian exports, and Ecuador can benefit from working with a more developed economy.



Currently, the economic policy of the Ecuadorian government is focused on developing the productive sector in the country, increasing the level of employment, promoting investment (both local and foreign) and including national products to productive linkage. These actions have been taken to support entrepreneurs and small and medium size firms and, of course, to promote trade that benefits Ecuadorian consumers. To accomplish this, a number of tariff barrier actions have been eliminated.

<sup>4</sup> Ventura, Jaume (1997). "Growth and Interdependence". Quarterly Journal of Economics, 112, February, 57-84.

## Actions to eliminate and reduce tariffs and optimize global trade

A summary of these actions related to reducing/eliminating duties and also oriented to optimizing global trade is presented below:

- ▶ **Reduction of duties for tariff lines related to raw materials and capital goods mainly used in segments within sectors considered priorities, such as, agriculture, aquaculture, fisheries, construction, transport, textile, plastic, among others. According to the government, the segments that will benefit from these duty reductions represent 38% of total GDP and generate approximately four million jobs, which represents 50% of the economically active population.**

**Table 1**

HS2 (*)	Count subheadings (**)	Description	Duties (%) – before	Duties (%) – after
12	1	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	5	0
23	8	Residues and waste from food industries; prepared animal fodder	5/15/20	0
25	1	Salt; sulphur; earths and stone; plastering materials, lime and cement	5	0
27	1	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	10	0
28	1	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare- earth metals, of radioactive elements or of isotopes	5	0
32	4	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other coloring matter; paints and varnishes; putty and other mastics; inks	5/15	0/3.75/7.5
35	1	Albuminoidal substances, modified starches, glues, enzymes	15	0
38	15	Miscellaneous chemical products	5/10	0/3.75/7.5
39	11	Plastics and articles thereof	5/10/15	0/3.75/7.5
40	3	Rubber and articles thereof	5/15	3.75/7.5
48	10	Paper and paperboard; articles of paper pulp, of paper or of paperboard	5/10/15	0/7.5
52	4	Cotton	15	7.5
54	5	Man-made filaments; strip and the like of man-made textile materials	10/15/20	7.5/15
55	1	Man-made staple fibers	15	7.5
56	4	Wadding felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	10/15	0/7.5
59	4	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	15/20	0/15
64	1	Footwear, gaiters and the like; parts of such articles	15	7.5
68	4	Articles of stone, plaster, cement, asbestos, mica or similar materials	15	0/11.25
70	4	Glass and glassware	10/15	0/7.5
73	16	Articles of iron or steel	5/15/25	0/7.5
76	3	Aluminum and articles thereof	5/15	0/7.5

**Table 1 (continued)**

HS2 (*)	Count subheadings (**)	Description	Duties (%) – before	Duties (%) – after
79	2	Zinc and articles thereof	15	0/7.5
82	1	Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal	5	0
83	11	Miscellaneous articles of base metal	15/20	0/7.5
84	92	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	5/10/15/25	0/3.75/1.25/
		7.5/18.75		
85	23	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	5/10/15	0/3.75/11.25/
		7.5/3.8		
87	11	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof	3/5/10	0/5
90	17	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	5	0/3.75

Source: Resolution No. 023-2019 issued by Ecuadorian Global Trade Committee published in the Official Gazette No. 56 on 8 October 2019

(\*) The information regards the changes in the duties was summarized for purposes of this article to two-digit code of the HS. To confirm specifics subheadings, it could be consulted the Resolution No. 023-2019 issued by Ecuadorian Global Trade Committee published in the Official Gazette No. 56 on 8 October 2019.

(\*\*) Number of subheadings subject to changes in the duties per HS 2 code.

► **The government is also looking to spur access to technology for the general population, and also considered the elimination of duties to “technology goods”:**

**Table 2**

HS6	Description	Duties – before	Duties – after
847130	Portable automatic data processing machines, weighing not more than 10kg, consisting of at least a central processing unit, a keyboard and a display	10	0
847141	Comprising in the same housing at least a central processing unit and an input and output unit, whether or not combined	10	0
847149	Other, presented in the form of systems	10	0 (*)
851712	Telephones for cellular networks or for other wireless networks	15	0
980720 (**)	Smartphones		

Source: Resolutions No. 024-2019 and No. 025-2019 issued by Ecuadorian Global Trade Committee published in the Official Gazette No. 56 on 8 October 2019

(\*) Only applicable to desktops.

(\*\*) Applicable to smartphones imported under Ecuadorian special regime of “Postal traffic and courier.”

- ▶ **Optimization of processes that reduce times in customs from 5.5 days to 3.8 days (according to statistics of the Customs Authority – Servicio Nacional de Aduanas del Ecuador SENA).**
- ▶ **Some of the quality regulation documents for imported products have been removed during 2019 (especially in the last half of the year) making the import process easier. By the end of 2013, a regulation from the Ecuadorian Global Trade Committee was published establishing as an import requirement the obligation to obtain a recognition of conformity certificate for certain goods. These requirements create a bottleneck that increased significantly the times for customs clearance due to the paperwork required for this process. A list of the regulations removed during 2019 is shown in Table 3.**

**Table 3**

Regulation	Description	Subheading	Derogation date
RTE INEN 009	Domestic use devices for cold generation	Several subheadings included in HS 84.18	1/24/2019
RTE INEN 010 (2R)	Ceramic products; crockery for domestic use	Several subheadings included in HS 68.15 and 69.11	1/24/2019
RTE INEN 015	Labeled	Not defined	4/17/2019
RTE INEN 023	Drinking water	Not defined	8/30/2019
RTE INEN 035 (1R)	Power efficiency for domestic use devices for cold generation	Several subheadings included in HS 84.18	1/24/2019
RTE INEN 052	Health and safety rules for works with chrysotile asbestos	Not defined	8/30/2019
RTE INEN 075 (1R)	Foods for special dietary uses	Several subheadings included in HS 19.01, 20.05, 20.07, 21.04, 21.06	8/30/2019
RTE INEN 081	Fired bricks	Several subheadings included in HS 69.02	8/30/2019
RTE INEN 099	Injection rubber-molding machines	8477.10.00.00 and 8477.80.00.00	8/30/2019
RTE INEN 102	Sorting machines for aggregates	8474.1	8/30/2019
RTE INEN 107	Ethyl alcohol	2207.10.00 y 2207.20.00.90	8/30/2019
RTE INEN 114	Loudspeakers	8518.21.00.00; 8518.22.00.00 y 8518.29.00.00	8/30/2019
RTE INEN 116	Bakery oven	8417.20.9000 and 8417.80.9000	8/30/2019
RTE INEN 118 (1R)	Audio-frequency electric amplifiers for professional or domestic use	Several subheadings included in HS 85.18	8/30/2019
RTE INEN 120	Air-powered tools	Several subheadings included in HS 84.67	8/30/2019
RTE INEN 130	Bearings	Several subheadings included in HS 84.82	8/30/2019
RTE INEN 131	Health and safety rules for works of food processing	Several subheadings included in HS 84.19, 84.20, 82.10, 84.34, 84.35, 84.36, 84.37, 84.38 and 84.78	8/30/2019
RTE INEN 140	Flanges for drinking water pipelines	Several subheadings included in HS 73.07, 84.84, 39.26, 40.16, 73.18	8/30/2019
RTE INEN 146	Printing, coloring and transparent inks	3215.19.00	8/30/2019

**Table 3 (continued)**

Regulation	Description	Subheading	Derogation date
RTE INEN 163	Candles, tapers and similar	3406.00.00	8/30/2019
RTE INEN 164	Wax floor finishes	Several subheadings included in HS 34.05	8/30/2019
RTE INEN 175	Cotters and cotter pins	7318.24.00	8/30/2019
RTE INEN 178	Expandable anchor bolts	7318.15.10	8/30/2019
RTE INEN 187	Pet food	Several subheadings included in HS 23.09	8/26/2019
RTE INEN 188	Labeled for pet food	Several subheadings included in HS 23.09	8/26/2019
RTE INEN 190	Operating tables and parts	9402.90.10.00	8/26/2019
RTE INEN 202	Copiers, printers, multifunction devices, etc.	Several subheadings included in HS 84.43 and 84.71	8/26/2019
RTE INEN 209	Labeled for cellphone cases	3926.90.90	8/30/2019
RTE INEN 230	In-shell pistachios	0802.51.00.00	8/26/2019
RTE INEN 232	Fat and oil used on frying process	Not defined	8/26/2019
RTE INEN 233	Tourist signage	Not defined	8/30/2019
RTE INEN 248	Paving stones	6801.00.00	8/30/2019
RTE INEN 258	Labeled for fungicides, insecticides and other pesticides for domestic use	Several subheadings included in HS 38.08	8/26/2019

Source: List of Regulations issued by the Servicio Ecuatoriano de Normalización

► **A tax bill came into force from 1 January 2020 that established a simplified procedure for exporters to obtain the refund of applicable custom duties (except VAT); with this new procedure the exporter should automatically be provided with a “credit note” from the Customs Authority once the definitive export customs return has been filed.**

Even though there is still a long path to develop the global trade in Ecuador, the business sector has welcomed these government actions after so many years of restrictions to international commerce. ■

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# Canada's Border Service Agency's new Assessment and Revenue Management project

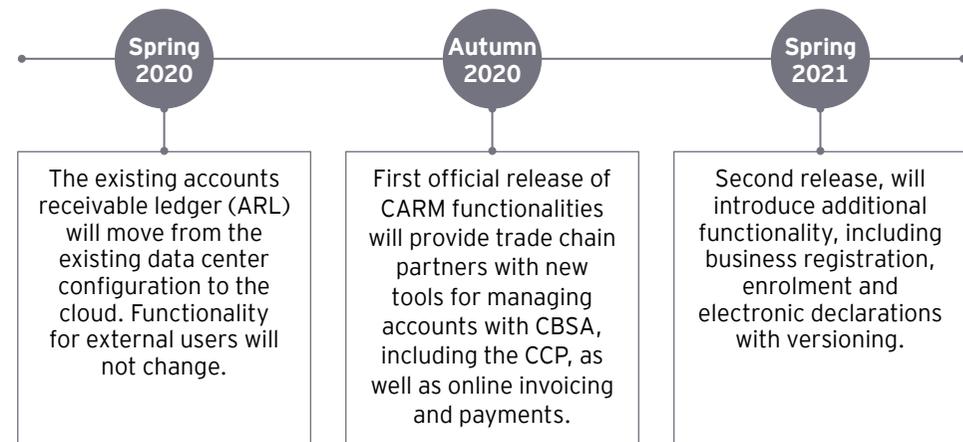
## Background

The Canada Border Services Agency (CBSA or the Agency) is undertaking a large-scale transformational initiative known as the CBSA Assessment and Revenue Management (CARM) project. CARM will have vast implications for the way importers and their representatives interact with the CBSA and will dramatically change the way accounting obligations under the Customs Act (the Act) are effectively carried out in day-to-day operations. In this article we focus particularly on introducing the CARM implementation timeline and considering the procedural implications and potential regulatory developments that will transform the customs accounting process for goods imported into Canada.

## What is CARM?

As a business transformation initiative by the CBSA, CARM changes business processes and expands the digital solutions available to the trade community. It incorporates business process transformation initiatives – such as new billing cycles, streamlined post-entry and recourse procedures and opportunities for importers to interface directly with customs – and deploys new digital solutions. As an early precursor of digital and systems transformation, and a “Phase 1” of CARM, development of the accounts receivable ledger (ARL) – based on SAP Public Sector Collections and Disbursement software module technology – was started in 2010, though it was only implemented several years later. Development is ongoing for a second digital transformation solution, the commercial client portal (CCP or the Portal), scheduled for a phased-in release beginning in Autumn 2020. Among other objectives, the CBSA looks to CCP to significantly overhaul the customs accounting process.

## CARM implementation will be rolled out in three tentative phases:



### Commercial client portal access

One key outcome of the CARM transformational project is that CCP access will need to be granted by importers to their representatives (i.e., appointed trade advisors, customs brokers and service providers). Representatives will continue to require agency agreements to interact with the CBSA on behalf of the importers they represent (pursuant to s.10(2) of the *Act* and administrative guidance in Memorandum D1-6-1 – *Authority to Act as an Agent*), but importers will also have to grant CCP access to representatives via the portal, to ensure that consultants, customs brokers and other service providers are adequately authorized to provide applicable services.

### The customs accounting process: current and future state

Modernization of CBSA's accounting process is certainly overdue, with CARM itself having seen scheduled deployments revised several times between 2010 and present day. Currently, importers account for import duties and taxes primarily by relying on forwarders and customs brokers to provide data and documentation to customs. Pre-accounting transmission milestones are handled by the Accelerated Commercial Information (ACI) program, the Release Notification System (RNS) and the Accelerated Commercial Release Operations Support System (ACROSS). Accounting milestones build on these earlier prerequisites, by tying Form B3 Customs Accounting Document submissions made via the Customs Automated Data Exchange (CADEX) or via customs declaration (CUSDEC) to the cargo control number identifying a shipment that was previously reported to the CBSA by pre-accounting transmissions. These customs accounting systems also provide functionality for the transmission of single-record post-accounting "adjustments".

This multitude of electronic data interchange (EDI) solutions represents a generation of software and systems that date as far back as the early 2000s. They provide the current means for staggered, single-version, serial transmissions that reflect the regulatory milestones of the *Act*: Goods are reported by their carrier pursuant to s. 12 of the *Act*, released (often prior to accounting) pursuant to section 31 of the *Act*, and accounted for pursuant to section 32 of the *Act* on an EDI B3 transmission. Formal adjustments (pursuant to sections 32.2 and 74 of the *Act*) can still be filed in paper form, which, when

coupled with a blanket adjustment process that is an off-the-grid workaround to address current systems limitations, often results in import transaction record inconsistencies. This highlights the inability of CBSA's current state digital ecosystem to handle versioning of import transaction records. Consequently, it comes as no surprise, that informal "corrections" do not exist outside the very limited scope of Release on Minimum Documentation (RMD) Correctors, B3 Type H and B3 Type V declarations.

Significant changes are foreseeable in accordance with CARM's CCP implementation objectives, as communicated by the CBSA to the consultative body of industry stakeholders known as the Trade Chain Partners Group (TCPG). This cloud-hosted CCP solution will provide real-time continuous transmission capabilities and new versioning capabilities for the Commercial Accounting Declaration (CAD) submissions made via the portal – which will replace EDI B3 transmissions. CCP real-time transmission and CAD versioning makes possible a new set of accounting milestones, as elaborated under the CARM framework:

- ▶ **CAD submission via portal** – this will fulfill the importer's regulatory obligation to account for the imported goods pursuant to the provisions of section 32 of the *Act*; like its predecessor, the B3 Type AB, the CAD continues to be required within five days after the goods are released under section 31 of the *Act*. This accounting continues to be, for all intents and purposes, a self-assessment of duties and taxes payable – unless, exceptionally, a CAD is selected by CBSA for review before the next ARL billing cycle, when payment of assessed amounts becomes due.



- ▶ **“Correction” submission via portal** – as long as payment does not become due (and unless the CAD was selected by CBSA for review), importers and their representatives are expecting, based on CBSA released information, to have unlimited opportunities to overwrite the initial CAD with new “corrected” versions. Just like the initial CAD submission, corrections are understood to remain a unilateral self-assessment, as no CBSA involvement would be required to confirm the changes.
- ▶ **“Adjustment” submission via portal** – adjustments can be filed via the portal to meet section 32.2 obligations with respect to corrections due when the importer has a “reason to believe” that the final CAD version on which payment became due was incorrect. Unlike corrections, the number of adjustments will continue to be limited by the privative clauses under subsections 58(3) or 59(6), and section 62 of the Act, and the process is expected to remain essentially the same with a single redetermination and a single request for further redetermination under each of the three compliance programs: origin, valuation and tariff classification.

### Possible legislative/regulatory changes?

While the CBSA’s CARM project leadership has indicated that legislative and regulatory changes may not be required, the introduction of a pre-adjustment correction mechanism introduces uncertainty around the interpretation of the

expression “interim accounting” under subsection 32(2)(a) of the Act, alongside further pertinent prescriptions made in the *Accounting for Imported Goods and Payment of Duties Regulations* (SOR/86-1062). Previously, a single interim accounting was required to allow goods to be released (through a process known as release on minimum documentation) before final accounting of duties and taxes owing was specifically/actively acknowledged by filing a final accounting on a B3 Type AB. Now, as the final accounting only truly occurs once payment becomes due on a CAD, does that mean that the CAD and all its versions could each be interpreted to be an interim accounting?

If multiple interim accountings become possible through the life cycle of an import transaction, provisions such as subsection 4 (1) of the *Accounting and Imported Goods Regulations* become far more difficult to interpret and apply: “Every person who accounts for goods [...] or who makes an interim accounting in respect of goods under subsection 32(2)(a) of the Act shall provide, **at the time of accounting and before the goods are released**, [...] every certificate, licence, permit or other document and any information that is required to be provided under the Act or these Regulations or under any other Act of Parliament or regulations made pursuant thereto that prohibits, controls or regulates the importation of goods” [emphasis added]. How will the interface between CCP and the parallel Single Window Interface (SWI) system designed specifically for such controlled goods information reconcile an importer’s obligations in such a situation?

### Impacts on the import trade community

Although CARM will initially impact operational realities for importers and will require a significant amount of change management for businesses, it should ultimately lead to a more efficient importing process. Efficiencies gained through CARM should ideally mean that the operational costs of trade compliance and consequently the true cost of importing into Canada is reduced. While regulatory changes may ultimately be required, despite CBSA affirmations to the contrary, their impact is unknown at this time. It is likely these will be minimal changes required to maintain regulatory framework consistency rather than an overhaul of the regulatory underpinnings of the customs accounting process.

As pertains to the specifics of the customs accounting process, importers with a technically strong, agile and well-equipped trade compliance function will be able to capitalize on new opportunities afforded by the newly introduced correction period, reducing the need for adjustments processing. CCP will help businesses with “getting it right” more often, before needing to avail themselves of the formal and often lengthy adjustment process. ■

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# Issues affecting customs administrative processes in Mexico



On 3 May 2019, Mexican President Andrés Manuel López Obrador, issued a memorandum that introduced national austerity measures within the government. These apply to the entire Federal Public Administration, including government agencies, decentralized organisms, financial public institutions and the Mexican Social Security Institute, among others.

Specific actions include the elimination of nongovernmental employees and high rank positions in the federal delegations of government agencies, and budget cut-backs. These measures are aimed at benefitting the country. However, they have

also taken a toll on response times for customs administrative processes and created additional requirements being requested by the authorities due to their lack of personnel.

A prime example relates to authorizations granted by the Ministry of Economy. On 9 December 2019, the Daily Gazette published an agreement that amends the Rules and General Criteria in Foreign Trade related matters issued by the Ministry of Economy (Foreign Trade Rules by the Ministry of Economy), finalizing a 23 July draft. The amendment to these rules removes the obligation for inspection visits made by the Ministry of Economy prior to granting

an authorization. The visits are now optional, but require the business make use of the services of a public notary or public business notary to confirm business practices.

The following authorizations require a notary instrument issued by a public notary or public business notary:

- ▶ New maquiladora, manufacturing and export services industry (IMMEX) programs, in any of its categories
- ▶ Extensions to the IMMEX program
- ▶ Sensitive Products extensions under an IMMEX program
- ▶ Changes in the registry of submaquila companies
- ▶ Changes in categories of IMMEX programs
- ▶ Enrollment of a new address under the IMMEX program
- ▶ Sectoral promotion (PROSEC) program authorizations, extensions and changes in address
- ▶ Extensions to the Remanufacture, Refurbishment and Repair program

Each authorization has certain requirements that have to be met by the Notary Instrument. Generally, they must address the following requirements:

- ▶ Location and addresses where the production or service processes will take place, including the characteristics, conditions, details of the premises, area in square meters, attaching photographs

- ▶ The status of the legal possession of the premises, and the document that proves it
- ▶ Inventory of machinery and equipment in which the production process takes place, attaching photographs and documents that prove their legal possession
- ▶ Description of the goods to be temporary imported and description of the physical space where they will be stored, attaching photographs
- ▶ In the case of temporary imports, its inventory and photographic support
- ▶ Number of employees and the activities undertaken, attaching photographic proof and documented proof of the payment of the workers compensations and taxes before the labor authorities

These documents are lengthy in size, requiring storage capacity, and they must be attached alongside other documents required for each type of authorization. There have been technical issues when uploading them to the Single Contact Foreign Trade website. Although the site states that you can upload 10 megabytes of information, it continues to accept only up to three megabytes of capacity. As a result, documents have to be scanned in a manner that degrades legibility. In addition, they have to be sent the same day to a specific email address set up by the Ministry of Economy ([dgce.tramites@economia.gob.mx](mailto:dgce.tramites@economia.gob.mx)) complying with specific requirements to be taken into consideration.

<sup>1</sup> With information by the Ministry of Economy, 2019 numbers until November 2019  
<sup>2</sup> As explained in official letter 414.2019.4260 issued on 13 December 2019

Additionally, the notaries are required to send their notary instrument in pdf format via email to the Ministry of Economy, including the tax ID, fiscal name and the 25-digit folio number that was generated by the Single Contact Foreign Trade Website when submitting the application.

Likewise, response times that authorities have to issue a response were increased. IMMEX and PROSEC program authorizations and sensitive products extensions under an IMMEX program are now 15 working days, up from 10 working days. Other authorizations related to the IMMEX program are now 10 working days, instead of five working days.

In practice, these response times have not been met by the Ministry of Economy. Authorizations that previously were obtained between two or three days are taking, due to various reasons, are often taking a month or longer. Also, in many cases the reviewers are issuing information requirements for the authorization request, and we have observed an increase in denials of approval.

Statistics on IMMEX program authorizations demonstrate the current delays:

Category	2018	2019 <sup>1</sup>
Shelter	5	4
Industrial	211	111
Service	127	65

As can be seen, there was a decrease of 52% in authorizations in 2019 compared to the previous year.

An additional amendment made to the Foreign Trade Rules by the Ministry of Economy applies to the import of goods that require an automatic notice, prior or automatic permit. The new requirement is that the unit price and the values declared in the permit must match with the one declared on the commercial invoice used for import. If not, the permit will not be valid. Under this situation, we can find the automatic notices for steel products and the automatic permit for goods that are subject to minimum estimated prices, such as shoes and textiles<sup>2</sup> are deficient.

Finally, due to the fight against corruption set out by the Mexican president, the open communication that the Ministry of Economy had in the past with foreign investors has dramatically changed, closing almost all direct communications between individuals and the Ministry of Economy officials.

To avoid any set back in investment and operation plans in Mexico, importers dealing with the Ministry of the Economy regarding any of the special programs referenced above should plan accordingly for these significant differences in processing time when submitting any new request. ■

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# New Repetro-Manufacturing regime for the oil and gas industry in Brazil

The oil and gas industry in Brazil is facing an optimistic scenario as it expects a significant increase in oil and gas production in the next few years. At the same time, Brazil's tax environment is known to be complex and challenging for the companies in the sector to navigate. Nevertheless, the oil and gas sector has always been greatly incentivized in the country with special taxation and customs regimes.

In July 2019, the Brazilian Federal Revenue enacted Normative Instruction 1,901, which regulates a new special regime for the oil and gas industry. It is called the Repetro-Manufacturing (Repetro-Industrialização). The regime provides the local manufacture of goods used in the exploration, development and production of oil, gas and other hydrocarbon fluids with a lower tax burden.

The Repetro-Manufacturing regime grants full suspension of federal and state taxes. The Brazilian tax authorities list the following as eligible for Repetro or Repetro-Sped regimes in the local acquisition or importation of raw materials, intermediary products and packaging materials used in the manufacturing of the finished products:

- ▶ Import duties (II)
- ▶ Federal excise taxes (IPI)
- ▶ Social integration contributions (PIS)

- ▶ Social security contributions (COFINS)
- ▶ State VAT (ICMS)

The manufacturing regime also suspends federal taxes for local sales of the finished products and grants a reduced 3% rate of the ICMS, provided the products are sold to companies benefiting from Repetro or Repetro-Sped.

The beneficiaries of the Repetro-Manufacturing regime are manufacturers of end products to be supplied directly to a Repetro or Repetro-Sped beneficiary and intermediary manufacturers of goods to be supplied directly to such end-product manufacturers.

Companies interested in using the regime must file a request in their jurisdiction with proof documentation that they fulfill all requirements. Some of those requirements are:

- ▶ Maintain contractual bond with at least one Repetro or Repetro-Sped beneficiary
- ▶ Incorporate the "Block K" file (detailed information on manufacturing, production, inventory) into the taxpayer's SPED file (electronic tax file), including a bill of material (BOM) and the percentages related to production losses
- ▶ Issue a "NF-e" (mandatory electronic invoice) for all inbound and outbound goods

The concession of the regime will be granted through an Executive Declaratory Act (ADE) and will be valid until December 2040. The beneficiary must comply with the requirements mentioned above at all times. If, at any moment during the concession, the beneficiary fails to comply with one of the



requirements, the use of the regime is suspended, and the beneficiary is not allowed to perform new operations under the regime until regularization.

The beneficiary must carry out the manufacturing process with the goods acquired under the regime and the final sale within a one-year period, counting from the customs clearance or the issuance of the acquisition invoice. An extension may be requested for an additional one-year term. For goods that require a longer production cycle, the term of validity will be set for a longer period on a case-by-case analysis, limited to five years, but extendable in exceptional cases.

As mentioned before, the sale of the final product to a Repetro or Repetro-Sped beneficiary company will be carried out with tax suspensions. However, if that company does not use the goods acquired for Repetro or Repetro-Sped activities within three years, it will be obliged to collect the suspended taxes due by the manufacturer. This term may be extended for up to 12 months in exceptional cases.

In order to control the regime and provide proof of fulfillment of all requirements and obligations, companies must set end-to-end controls of their operation, from the acquisition of materials under the regime, inventory, their use in the manufacturing process and the sale of the corresponding final goods to another beneficiary. Although it is not necessary to establish separate inventories for goods under the regime, the beneficiary must be able to track its utilization in the manufacturing process. For the purposes of monitoring the companies' fulfillment of the commitment to industrialization, the IRS shall

take into account operations carried out under the regime according to the "first in, first out" (FIFO) accounting criteria.

In the case of noncompliance with the regime or any of its requirements, all taxes suspended on the acquisitions shall be levied with the corresponding legal increments.

Finally, not all issues and scenarios are addressed by the current legislation, which still creates some uncertainty for the sector. New legislation is expected to surface in the next months and should bring a

better understanding of how the regime must be operationalized and controlled by the beneficiaries. Nevertheless, companies are already preparing for and adapting to this new structure for the oil and gas industry in Brazil. ■



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# Overview of the Pacific Alliance and its development

The Pacific Alliance is a regional trade bloc formed by Colombia, Chile, Mexico and Peru in 2011. Its founding instrument, the Pacific Alliance Framework Agreement, was signed on 6 June 2012 in Chile. It was created to optimize the cooperation among its member countries, taking advantage of their locations and with the aims of (a) building an area of deep economic integration; (b) moving gradually toward the free circulation of goods, services, capital and people; (c) promoting economic development and regional competitiveness; and (d) becoming a platform for political articulation and economic and trade integration, with a special emphasis on the Asia-Pacific region<sup>1</sup>.

The Pacific Alliance parties have agreed on a series of commitments to make customs' procedures more effective and simplified, as well as streamlined methods, processes and action systems based on risk management. The alliance is recognized globally as one of Latin America's greatest successes in terms of economic integration. These achievements are important to Pacific Alliance success, as demonstrated by the good economic stability of its Member States, as well as the large number of trade agreements that these countries have.

Currently, the Alliance is the eighth economic power and the eighth export force worldwide and, in Latin America and the Caribbean, it represents 38% of the GDP, 50% of the total trade and attracts around 45% of the Foreign Direct Investment.<sup>2</sup> This group is increasingly establishing itself as one of the world's leading economic partners. Although it was originally established with a special emphasis on the Asia-Pacific region, nowadays, it has a great projection in the European and American markets.

In 2018, during a summit in Puerto Vallarta, Mexico, the program "Strategic Vision 2030" was approved. Its goal is to continue promoting and consolidating integration, while driving greater growth, development and competitiveness. These steps will help achieve the Alliance's sustainable development goals, to ensure the free circulation of goods, services, capital and people by 2030. In addition to the Puerto Vallarta summit, important meetings have been held recently to set up clearer



<sup>1</sup> M Angeles Villarreal; *The Pacific Alliance: A Trade Integration Initiative in Latin America*. Available at <https://fas.org/sgp/crs/row/R43748.pdf>

<sup>2</sup> *Pacific Alliance, what is the pacific alliance?* Available at <https://alianzapacifico.net/que-es-la-alianza/>



commitments and objectives that will allow the alliance to be much more efficient and competitive. Previous summits include:

- ▶ The 8th Pacific Alliance Summit, Cartagena, Colombia, 10 February 2014, during which the tax relief protocol of 92% of tariffs was signed.
- ▶ The 12th Pacific Alliance Summit, Cali, Colombia, 30 June 2017. Member State presidents announced the start of negotiations with Australia, Canada, New Zealand and Singapore

to ultimately assign these countries the status of “Associated States.”

- ▶ The 13th Pacific Alliance Summit. Puerto Vallarta, Mexico, 24 July 2018. The Strategic Vision 2030 was approved and establishes the PA’s objectives and goals for the next 12 years.
- ▶ Finally, the 14th Pacific Alliance Summit, Lima, Peru, 6 July 2019. A commitment to implement a collective financing platform for micro, small and medium companies was improved, in coordination with the Technical Innovation Group and Financial Integration Working Group.

<sup>3</sup> Peruvian Super intendency of Customs and Tax Administration, what are the mutual recognition agreements? Available at <http://oea.sunat.gob.pe/SUNAT%20Y%20ADUANAS%20DE%20COREA%20SUSCRIBEN%20ACUERDO%20DE%20RECONOCIMIENTO%20MUTUO>

Since the agreement became effective, member countries have achieved several benefits. These include the reduction of tariffs to 92% of the headings and the optimization of the global value chains through the accumulation of origin of one or more of the countries. This allows them to take advantage of value chains and the full range of activities that can be performed to carry a product from conception to production and end use, including tangible and intangible value-added activities. Additionally, micro-, small- and medium-sized enterprises (SMEs) have benefited from regional opportunities with business initiatives and services, such as the Network of Business Development Centers, SME Public Policy Index and Easy Export Tool.

Finally, another important achievement is facilitating intra-regional trade through strengthening the customs Authorized Economic Operator (AEO) program. To archive this goal, member countries met in April 2015 to, among other things, establish a Mutual Recognition Agreement (MRA). This means that validations and authorizations granted to an AEO in one country are recognized by other countries that are part of the program, thereby giving mutual benefits; as well as eliminating duplicity of security controls.<sup>3</sup>■

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# United States Department of Justice revised export control and sanctions enforcement policy for voluntary disclosures

The United States (US) Department of Justice (DOJ) recently issued a revised policy relating to voluntary self-disclosures (VSD) of export control and sanctions violations (“revised VSD policy”). Building on its prior guidance, the revised VSD policy maintains DOJ’s priority in protecting sensitive US technologies and preventing transactions with sanctioned jurisdictions and targets, while encouraging the private sector to come forward and report any criminal violations of export control and sanctions programs. The DOJ does this by providing more concrete criteria and incentives for the resolutions of such voluntarily disclosed matters.

In short, the revised VSD policy sets forth certain defined incentives for companies – both in cases where aggravating factors are present or absent – that:

1. Voluntarily self-disclose an export control or sanctions violation
2. Fully cooperate
3. Timely and appropriately remediate

However, the revised VSD policy suggests that companies will not receive any VSD credit from DOJ if a potentially “willfull” violation is not directly reported to the DOJ’s National Security Division (NSD), and instead only reported to other US government agencies responsible for the

administration of applicable US export control and sanctions regimes, which have their own respective VSD guidelines.

## Background

On and effective from 13 December 2019, DOJ<sup>1</sup> issued the “Export Control and Sanctions Enforcement Policy for Business Organizations” that supersedes its prior 2 October 2016 guidance.<sup>2</sup> The revised VSD policy seeks to encourage and further incentivize companies – who DOJ claims are at the forefront of US efforts in combating export control and sanctions violations – to voluntarily self-disclose directly to the DOJ’s National Security Division all potentially *willfull* violations of the government’s primary export control and sanctions regimes. This includes the Arms Export Control Act (AECA), 22 USC. § 2778, the Export Control Reform Act (ECRA), 50 USC. § 4801 et seq., and the International Emergency Economic Powers Act (IEEPA), 50 USC. § 1705.<sup>3</sup>

1 Policy issued specifically by the National Security Division’s Counterintelligence and Export Control Section.

2 Department of Justice, Export Control and Sanctions Enforcement Policy for Business Organizations, Dec. 13, 2019, available at <https://www.justice.gov/opa/pr/departments-justice-revises-and-re-issues-export-control-and-sanctions-enforcement-policy>.

3 *Id.* (emphasis added). For purposes of export control and sanctions cases, NSD’s revised VSD policy relies on the definition of willfulness set forth in *Bryan v. United States*, 524 USUSUSUS 184 (1998), where an act is considered willful if done with the knowledge that it is illegal. However, NSD states that it is not required to show the defendant was aware of the specific law, rule or regulation that its conduct may have violated.



The DOJ's revised VSD policy attempts to further encourage and incentivize VSDs of all potentially willful violations of the foregoing statutes through three key changes from NSD's predecessor guidance:

1. Clarifies the benefits that are available to companies that voluntarily disclose a violation, fully cooperate with NSD, and timely and appropriately remediate.
2. Clarifies that disclosure of potentially willful conduct made to regulatory agencies, and not to DOJ, will not qualify for the benefits provided in the revised VSD policy.
3. The revised VSD policy was drafted to more closely resemble existing and analogous guidance from other DOJ components in an effort to standardize, to the extent possible, DOJ voluntary disclosure policies. Specifically the definitions of "voluntary self-disclosure," "full cooperation," and "timely and appropriate remediation" are intended to closely mirror those provided in DOJ's Foreign Corrupt Practices Act (FCPA), Corporate Enforcement Policy.

The NSD's position is that almost all criminal violations of US export control and sanctions laws harm or potentially harm national security objectives. This ultimately informs how DOJ will arrive at an appropriate resolution with a violating company. Nevertheless, pursuant to the revised VSD policy, criminal prosecutors are instructed to balance the goal of encouraging VSDs and cooperation by a subject company, with the goal of future deterrence of such serious offenses to the national security interests of the US.

### Key terms of VSD policy

The term "voluntary self-disclosure" is defined to require a company to satisfy the following elements:

1. Disclosure occurs prior to an imminent threat of disclosure or government investigation.
2. Disclosure occurs within a reasonably prompt time after becoming aware of the offense, with the burden on the company to demonstrate timeliness.
3. The company discloses all relevant facts known to it at the time of the disclosure, including as to any individuals substantially involved or responsible.

DOJ further states that when a company identifies willful conduct, but chooses to self-report only to a regulatory agency and not to DOJ, the company will not qualify for the benefits of this policy in any subsequent DOJ investigation. DOJ also recognizes that a company may not be in a position to know all relevant facts at the time of a disclosure, especially where only preliminary investigative efforts have been possible, and that in such circumstances the company should make clear that it is making its disclosure based upon a preliminary investigation or assessment of information while nonetheless providing a fulsome disclosure of the relevant facts known to it at the time.

To receive credit for "full cooperation," the revised VSD policy requires several actions to be performed by the company in satisfaction of that term, including:

- ▶ Disclosure on a timely basis of all facts relevant to the wrongdoing at issue
- ▶ Proactive rather than reactive cooperation
- ▶ Timely preservation, collection and disclosure of relevant documents and information relating to their provenance
- ▶ When requested by DOJ, and as appropriate, certain steps for witnesses, company officers, and employee interviews and other investigative means
- ▶ To the extent that a company does not satisfy all the "full cooperation" elements, it may still be eligible for some cooperation credit.
- ▶ Finally, the terms "timely and appropriate remediation" are defined to require the following:
  - ▶ Demonstration of thorough analysis of causes underlying conduct, and when appropriate, remediation to address the root causes
  - ▶ Implementation of an effective compliance program that is appropriate for the size and resources of the organization
  - ▶ Appropriate discipline of employees identified by the company as responsible for the misconduct
  - ▶ Appropriate retention, and prohibition of the improper destruction or deletion, of business records
  - ▶ Any additional steps that demonstrate recognition of the seriousness of the company's misconduct, acceptance of responsibility and implementation of measures to reduce its repetition

### Benefits of VSD policy

In the absence of any aggravating factors,<sup>4</sup> DOJ's revised VSD policy provides that when a company satisfies the requirements of all three of the foregoing key terms, there is a presumption that the company will receive a non-prosecution agreement and will not pay a fine. However, at a minimum, even in cases where the company receives a non-prosecution agreement, the revised VSD policy does not permit the company to retain any of the unlawfully obtained gain and will be required to pay all disgorgement, forfeiture and/or restitution resulting from the misconduct at issue.

### Potential conflict of interest with other US government VSD programs

The new guidance clearly underscores the DOJ's increased enforcement of US export and sanctions controls and its willingness to work with disclosing

companies to help ensure the US government's national security interests. However, because the DOJ will not confer the benefits of the policy if a company only discloses a potentially "willful" violation to one of the regulatory agencies, it puts companies in a bind.

Although the revised VSD policy of DOJ primarily relates to violations of the Arms Export Control Act (AECA), Export Control Reform Act (ECRA) and International Emergency Economic Powers Act (IEEPA), these laws are primarily administered and enforced by three US government agencies.<sup>5</sup> Each of these agencies maintains their own enforcement guidelines and voluntary disclosure procedures and, under the appropriate circumstances, may refer such violations to DOJ for consideration of criminal prosecution, along with informing DOJ of the voluntary nature of the disclosure, the consideration of which is in DOJ's sole discretion.

This leaves a company that has engaged in any potential violations of export control or sanctions programs administered by such agencies in a conundrum. The company must itself first evaluate the "willful" nature of its violations, in considering whether to disclose to the regulating agencies alone and/or to DOJ.<sup>6</sup> Notwithstanding that such legal inquiries take time and may cause undue delays in a context where timeliness of a disclosure is a key consideration, determining whether an potential violation is "willful" in nature is made further difficult because how other agencies define and apply the term may not necessarily coincide with DOJ's adopted definition. For example, OFAC's enforcement and VSD guidelines also take into consideration the "willful" nature of an apparent violation – where

OFAC does not limit the definition of the term to DOJ's – where the disclosed violation may solely result in a civil enforcement action by OFAC, even where the apparent violation is deemed "willful" by the agency.<sup>7</sup>

If a VSD goes to DOJ, it may become the subject of a criminal investigation for a violation that may have not been referred to DOJ for a criminal investigation by the other agencies VSD programs, but who may have solely treated the violations as a civil enforcement matter. If it does not go to DOJ, but to one of the other agencies who in turn makes a criminal referral to DOJ, it will lose out on any of DOJ's revised VSD policy's benefits.

Companies should carefully and timely consider the cause and nature of any violations in deciding whether to disclose to the DOJ and/or to one of the regulating agencies. ■

<sup>4</sup> The revised VSD policy provides a non-exhaustive list of aggravating factors that are deemed to represent elevated threats to the national security of the US, and that if present to a substantial degree, could result in a more stringent resolution for a company that has engaged in criminal export control and/or sanctions violations. The list includes:

1. Exports of items controlled for nuclear nonproliferation or missile technology reasons to a proliferator country
2. Exports of items known to be used in the construction of weapons of mass destruction
3. Exports to a foreign terrorist organization or specially designated global terrorist
4. Exports of military items to a hostile foreign power
5. Repeated violations, including similar administrative or criminal violations in the past
6. Knowing involvement of upper management in the criminal conduct

<sup>5</sup> Department of State (Directorate of Defense Trade Controls), Department of Commerce (Bureau of Industry and Security) and Department of Treasury (Office of Foreign Assets Control).

<sup>6</sup> The revised VSD policy does not specify what position DOJ will take toward a disclosure if it is simultaneously disclosed both to it and any of the regulating agencies.

<sup>7</sup> See 31 C.F.R. Part 501, Appendix A, III. See *also supra* Note 3.

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# Regional Comprehensive Economic Partnership – true progress or an opportunity missed?

## The ambition

In 2012, the governments of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam (being Member States of the Association of Southeast Asian Nations (ASEAN)), together with Australia, China, India, Japan, New Zealand and the Republic of Korea commenced negotiations on a Free Trade Agreement (FTA) called the Regional Comprehensive Economic Partnership (RCEP). RCEP was always going to be an ambitious venture, being a “mega-FTA” that would cover more than 45% of the world’s population and more than a third of the world’s GDP. If realized, it would be an agreement that embraced some of the most significant developing markets in the world and create a platform for growth for many years to come.

## The challenge

If anything, as time moved on, RCEP assumed even greater significance as a potential riposte to the trade disruption that has shaken business assumptions of a benign international trading environment. Hope and anticipation has, with experienced RCEP watchers, coexisted with the understanding that creating such an FTA would be a phenomenal exercise in trade negotiation. This

was particularly true, since it would be the first comprehensive FTA that covered both China and India. There is, of course, the Asia Pacific Trade Agreement of which China and India are both members, but this is a limited scope FTA, and so the RCEP agreement covering China and India would be a huge step forward.

## The reality

And so it proved to be. At the third RCEP Summit held in Thailand between 31 October and 3 November 2019, after 7 years and 27 rounds of negotiation, the ASEAN countries, together with Australia, China, Japan, New Zealand and Republic of Korea, announced they had concluded text-based negotiations and that the RCEP agreement could be ready for signing by these governments in 2020. A deal had been done. However, an announcement was also made that *“India has significant outstanding issues, which remain unresolved. All RCEP Participating Countries will work together to resolve these outstanding issues in a mutually satisfactory way. India’s final decision will depend on satisfactory resolution of these issues.”* In other words, the original 16 members had become 15 members, with India deciding, at the last minute, not to join.



Why did India refuse to join RCEP? The reason given was there were concerns India could be swamped by cheap imports, particularly from China, putting its domestic industry and farmers at risk. India was unhappy that not all its concerns had been addressed, so it backed out. Is this a negotiating tactic for India to gain more “concessions?” Possibly. India has been known to push hard in negotiations and to exercise a degree of brinkmanship. And it may still work. Japan has indicated it may not sign up to RCEP without India as a member, with ongoing discussions between Japanese and Indian officials taking place. At the moment, it is still unclear if Japan will proceed with RCEP.

### Where next?

So, what are the next steps for RCEP? Leaving aside the uncertainty expressed by Japan, the RCEP agreement is scheduled for signing in 2020. RCEP countries are, thereafter, expected to perform their internal ratification to prepare for the implementation of the RCEP. Ratification can be a lengthy and complicated process for some countries, taking one to two years, and one cannot assume that ratification, and implementation thereafter, is a formality. An example is with the United States who withdrew from the Trans-Pacific Partnership (TPP) after signing the agreement. Four of the 11 signatory countries are also still to ratify its successor agreement, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

### Still of benefit?

An RCEP agreement without India would seemingly negatively impact the agreement. However, even without India, the 15 members of RCEP have a population of more than 2.25 billion with a combined GDP of approximately US\$24 trillion. RCEP has 20 chapters<sup>1</sup> and central to the FTA are the tariff concessions being offered by the respective importing parties against a common set of rules-of-

origin provisions that will apply to cross-border trade in goods between the parties. In effect, it will be one of the largest FTAs and one which is still predicted to bring considerable gains to participant countries.

If RCEP is implemented, what will happen to the existing network of FTAs that that are used by business? Governments rarely “cull” old FTAs, they usually just overlay the old agreements with the new FTA – the assumption being that the new FTA will offer enhanced benefits and so business will quickly gravitate to utilizing it. Conceivably, old FTAs may, for companies under specific circumstances, be better. This approach has the effect of leaving all benefits of old and new FTAs open to the business community.

### The implications

As companies plan for the future and make investments, they should still look to the benefits of both the RCEP and the current network of FTAs. With ASEAN having a comprehensive FTA with India, this could mean that ASEAN countries are well placed to benefit from the upcoming RCEP agreement, as well as have continued preferential access into India. Couple this with some ASEAN countries being members of the CPTPP, overlapping FTAs have the potential to offer some ASEAN countries a strategically advantageous position at a time when many companies are reviewing their manufacturing footprint in Asia. Even if the trade dispute between China and the US can be resolved, companies are focused on reducing their trade risk, with availing of FTAs a part of doing that. Some ASEAN countries are already a beneficiary of the trade dispute between China and the US, with

RCEP potentially cementing that position further as low-cost manufacturing locations that have a comprehensive network of FTAs accessing many key growth markets.

### The unknown

The text is still undergoing legal ‘scrubbing’ and has yet to be released, so further analysis will need to be made at that time and companies should study closely as to the opportunities offered. Japan could continue to raise doubts on moving forward with RCEP and others of the 15 countries may have challenges in ratification. India could also still spring a surprise by agreeing to terms of the RCEP if outstanding significant issues can be resolved in a mutually satisfactory way.

### Conclusion

The fact that an agreement has been reached between 15 countries should not be overshadowed by India’s decision not to join. There is a great deal of appetite from governments in Asia to create an FTA that will support growth in trade and send a positive message to business. RCEP is not fully baked, but what has been agreed is a milestone and something to be built upon. More than ever, companies need to pay close attention to RCEP. ■

<sup>1</sup> Chapters on: 1) Initial Provisions and General Definitions; 2) Trade in Goods; 3) Rules of Origin, including Annex on Product Specific Rules; 4) Customs Procedures and Trade Facilitation; 5) Sanitary and Phytosanitary Measures; 6) Standards, Technical Regulations and Conformity Assessment Procedures; 7) Trade Remedies; 8) Trade in Services, including Annexes on Financial Services, Telecommunication Services, and Professional Services; 9) Movement of Natural Persons; 10) Investment; 11) Intellectual Property; 12) Electronic Commerce; 13) Competition; 14) Small and Medium Enterprises; 15) Economic and Technical Cooperation; 16) Government Procurement; 17) General Provisions and Exceptions; 18) Institutional Provisions; 19) Dispute Settlement; and 20) Final Provisions.

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# Transfer pricing adjustments and customs in Asia-Pacific

For many years, companies have grappled with the issue of end-of-year transfer pricing adjustments and how to address these with customs authorities in the Asia-Pacific region. In this article, we'll look at how both customs and companies are addressing

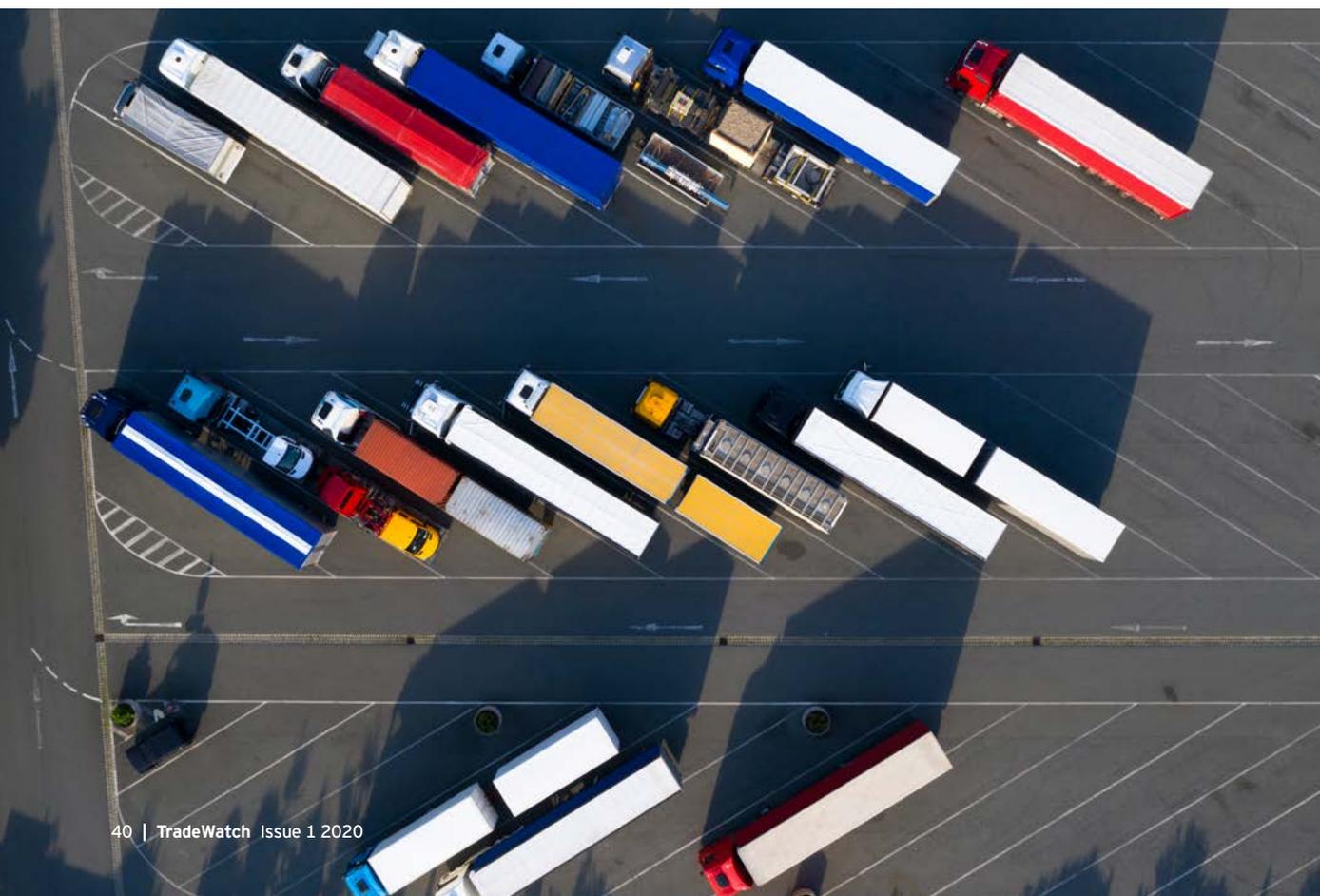
this issue and the latest developments in the region. Before we dive into the details, we should first define what we mean by a transfer pricing adjustment and also describe a common commercial scenario where transfer pricing adjustments frequently occur.

## Why are customs authorities interested in transfer pricing adjustments?

Related parties who trade with each other are required to declare a value for customs duties in respect of goods that move across borders. This value will be used to assess ad valorem duties. The primary method of valuing goods is the transaction value, being the price paid or payable for the goods between parties. This is commonly the invoice price of goods, subject to required additions and deductions to arrive at a customs value. The fact that a buyer and seller are related shall not in itself be grounds for regarding the transaction value as unacceptable. However, acceptance is conditional that the relationship did not influence the price.

In a common scenario, goods will be sold to a company who will act as the importer and distributor in an importing market. The distributor will have prescribed roles, risks and responsibilities and will have a target range of profitability, often expressed as a net margin percentage, that is determined as arm's length by reference to the profit margins of unrelated parties under comparable circumstances. The cross-border sales price will be calculated by reference to achieving a target net margin and arm's-length profitability of the distributor.

The challenge arises when the target profitability is not met and the distributing entity has a profitability that is outside the arm's-length range. Companies will seek to adjust the distributor's profitability, bringing the net margin back into the arm's-length range. They will do this by making a transfer pricing adjustment, this commonly being an end-of-year adjustment to the distributor's purchase price of the



goods and thus a post-importation adjustment to the previously declared customs value of imported goods. How then to address this transfer pricing adjustment with customs?

First, reference should be made to the Technical Committee on Customs Valuation (TCCV) Case Studies 14.1 and 14.2, which address the use of transfer pricing documentation when examining related-party transactions. 14.2 is particularly relevant as, in this case study, it includes a fact pattern where the importing distributor's profitability is not within arm's-length range and, with no "compensating adjustments," the customs value was not acceptable and alternative methods of valuation were to be used, i.e., the originally declared transaction value was to be rejected. In other words, if a transfer pricing adjustment should have been made and it wasn't, then the earlier declared prices are not viewed as meeting the arm's-length condition.

### **Differential treatment**

In discussions with some customs authorities in Asia, they are very much aware of TCCV Case Studies 14.1 and 14.2, and they have clearly interpreted them as requiring companies to declare transfer pricing adjustments to customs. Indeed, this is nothing new to many authorities, just reconfirmation of previously held positions. However, most customs authorities have not translated the requirement to declare transfer pricing adjustments into administrative procedures. A notable exception is New Zealand Customs who implemented a provisional values scheme to assist

importers in making post-import adjustments. Under the scheme, importers were required to register with New Zealand Customs to avoid financial penalties on customs value adjustments. Despite the availability of the scheme and the perception that it is being considered a success, only about 100 or so companies have registered under the scheme. Even without a statistical reference, this is surely a number considerably below the number of companies who do make transfer pricing adjustments in New Zealand.

In other countries, for example Indonesia, there are provisions that allow post-importation adjustments to reflect royalty payments, but there is no provision to allow for transfer pricing adjustments and, at audit, a company that makes adjustments without declaring them to customs can be subject to assessment and penalties.

### **Avoiding penalties and obtaining refunds**

For many countries, the position is that companies are required to use voluntary declaration programs (VDP) to declare transfer pricing adjustments – the same programs that companies use to declare errors to avoid penalties. VDP do not always allow for complete removal of penalties. For example, Singapore authorities always reserve the right to assess penalties. In practice, Singapore Customs are very supportive of business, with penalties, if any, being minimal for transfer pricing adjustments. However, there is still the potential for penalties, even if very limited, and is an inhibitor to some companies declaring transfer pricing adjustments to customs.

VDP are also not always available. Thailand has a VDP program that keeps being extended, up to 30 April 2020 for the last extension, but could conceivably not be available thereafter. An alternative in Thailand is to approach customs proactively, obtaining awareness and agreement from customs of a retrospective transfer pricing adjustment mechanism so as to avoid penalties and, potentially, even obtain a refund if the previously declared price is reduced.

However, refunds should not be recognized until funds have actually been received, as the general perception of transfer pricing adjustments and customs is that additional duties will need to be paid, with refunds rarely available. Indeed, there are obligations to declare duty underpayments that result from transfer pricing adjustments but, for example in Philippines, there is no obligation to declare a transfer pricing adjustment that results in a refund position, as filing for a refund is at the importer's discretion and not an obligation.

### **Being proactive**

General advice to companies across Asia-Pacific is to be proactive in engaging with customs around transfer pricing adjustments, making sure to deal with the experienced, technically aware, customs valuation officials to obtain an acknowledgement and agreement of not just that a transfer pricing adjustment will be taking place, but the administrative mechanism by which it can be declared, e.g., via a single "lump-sum" declaration or line-by-line adjustments for each prior import. There are also mechanisms in place in certain countries

to obtain rulings around arm's-length pricing for customs, e.g., the Advanced Customs Valuation Arrangement process in South Korea.

### **A reluctance to engage**

However, with inconsistent approaches to transfer pricing adjustments from customs authorities across the Asia-Pacific region, together with a general sense of caution in engaging with customs, many companies have often decided to not declare their transfer pricing adjustments. But not declaring transfer pricing adjustments is becoming a higher risk strategy. From several recent discussions with

various customs authorities, there is increasingly a very dim view being taken of companies that are tax-aware and sophisticated enough to be processing transfer pricing adjustments – often to reduce their corporate tax liability – yet are at the same time electing to not declare transfer pricing adjustments to customs where the customs duty costs would increase. In such circumstances, expect penalties and allegations of evasion to increase.

### **Comprehensive declarations – an obligation?**

Optionality itself may also start being a thing of

the past. A recent development with the Taiwan tax authorities is that transfer pricing adjustments need to be processed as a “package.” This requirement is from 2020 onward and precise details are still being released, but companies who wish to process one-time transfer pricing adjustments will need to have all the supporting agreements and documentation in place, and must make a payment or claim a refund, in respect of all the various direct and indirect taxes as a consequence of the transfer pricing adjustment.

### **Requirement to act**

In conclusion, although it is not possible to adopt a single-line approach in addressing transfer pricing adjustments with Asia-Pacific customs authorities, there is an increasing awareness among customs that this is a normal business activity for many companies and that companies should indeed be declaring transfer pricing adjustments. Customs are also very much on the lookout for transfer pricing adjustments as part of customs audits and will impose penalties for under declarations. With the environment changing, companies need to be proactive in managing transfer pricing adjustments and not think they have the option to declare them or not. ■

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## Brexit: latest state of play

The United Kingdom (UK) and European Union (EU) have now ratified the “Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community” (“Withdrawal Agreement”) negotiated in October 2019. As such, the “transition period” has now began.

As set out in the Withdrawal Agreement, most elements of EU law apply to the UK during the transition period, and references in EU law to “Member States” are understood to be as including the UK. As such, until the end of December 2020 – the point at which the transition period comes to an end, the trading environment between the UK and the EU is expected to remain substantively similar.

The UK will remain bound during the transition period by the obligations stemming from all EU international agreements, meaning that third countries keep the same UK market access. However, while the EU has agreed to notify other parties to international agreements that the UK is to be treated as an EU Member State for the purposes of these agreements during the transition period, it is possible that third countries concerned may not agree – and as such, if there is no specific agreement, UK originating exports may not be eligible for preference in these countries.

The transition period is due to end at the end of December 2020. Following this, there are three plausible next states – a Free Trade Agreement (FTA), no FTA or an extension to the transition period.

### **Actions for businesses**

Businesses should now focus on getting ready for the outcome of the transition period. Whether there is an FTA or no FTA, there will be a border between the UK and the EU. As such, businesses should be doing everything possible to ensure they are prepared for the new arrangements when they begin.

In preparation for a “no deal” Brexit (with no transition period), the UK Government offered easements such as Transitional Simplified Procedures (TSP) to mitigate border delays and unnecessary formalities. In addition, it was expected there would be a relaxed approach to customs enforcement. Businesses were thus enabled to focus on being “good enough” for the environment, with the main aim of preparations being to move goods with minimal risk of delay or challenge.

If there is a border after the transition period, easements such as TSP are likely to be unavailable and it is expected that the UK authorities will be less relaxed on compliance requirements, so businesses will need to shift focus from being “good enough” to being “good”. Practically, this means looking to ensure full international trade compliance. Key elements of this compliance include:

### **Tariff classification**

The UK and EU customs authorities require every item imported into, or exported from, either customs territory must have a classification code assigned to it. This is usually a 10-digit numeric code for imports (although in some cases it can be more) and 8 digits for exports.

Prior to the end of the transition period for UK to EU and EU to UK movements, only 8 digits were required to be reported for Intrastat purposes – and this obligation was not strictly enforced.

In the event that the transition period ends with either an FTA or no FTA, accurate classification will be required for every good imported or exported.

### **Customs calculation**

As with tariff classification, a border will require goods to be assigned a value for customs purposes (a customs value). This is a particular challenge where there is no underlying transaction in relation to the movement of goods, or the transaction is between related parties and as such, is not at “arm’s length.”

Recently, the UK authorities have been querying customs values – focusing on related party transactions and, in particular, the use of transfer prices as the basis of the customs value. Moreover, they are using analytics to identify apparent anomalies in customs valuation during audits – e.g., looking at average values per weight of an imported product over time and challenging if significant variations are found.

### **Origin**

Managing origin will be a challenge if there is an FTA between the UK and the EU – but will also be required for many importers if there is no FTA.

If claiming preferential duty rates on import, adequate proof of origin is required to be compliant. These origin requirements will also increase in complexity as the UK rolls-over current EU FTAs. As such, robust origin management systems need to be in place.



Some goods will not meet the new rules of origin – and as such, to manage cost, procedures such as inward processing and customs warehousing may be required to be utilized.

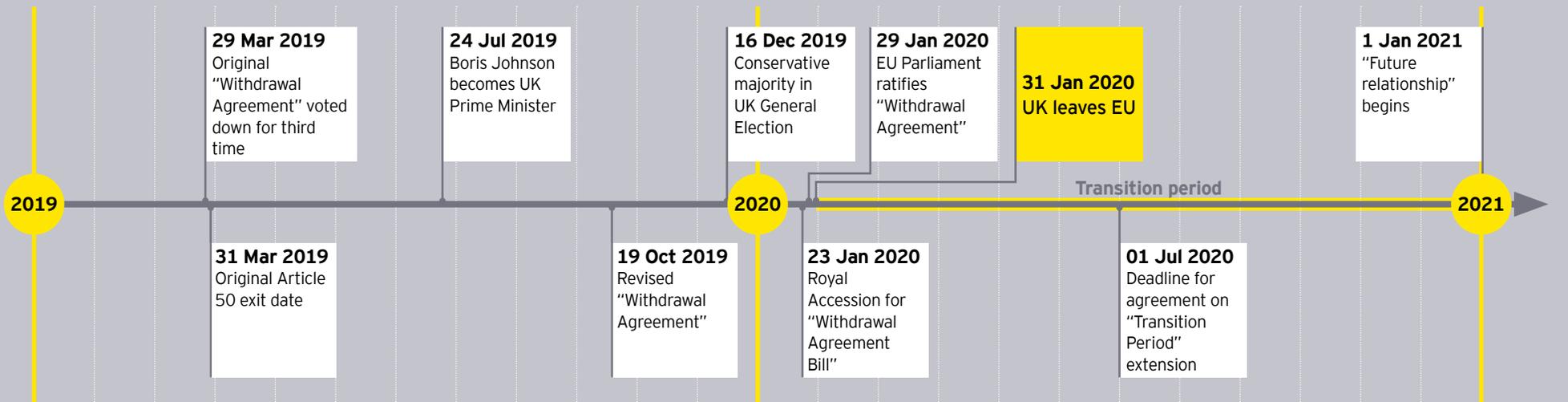
Once businesses are prepared for the new arrangements from an operational continuity perspective, then optimizations (e.g., using simplifications to reduce duties and/or border

delays bureaucracy, etc.) and opportunities can be explored. We can make assumptions as to what form any new UK FTAs (including with the EU) will take, by examining existing UK and EU FTAs. These can then be utilized for optimization and opportunity identification purposes – such as examining whether goods meet rules of origin from existing agreements to determine whether they are likely to qualify as originating goods for the purposes of claiming

preferential duty rates. Businesses may then decide to reprofile their manufacturing footprint or sourcing decisions to take advantage of this preferential origin under new FTAs.

The recommendation for businesses is that they should begin examining the impact of the proposed new arrangements in January and formulate a plan by the end of February. They will then have 10 months to implement this. ■

**Where are we now in the Brexit timeline?**



An article, *Brexit checklist: How to prepare your company for post-Brexit business*, by Franky De Pril, EY Global Trade Leader is available [here](#).

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# Customs valuation cases in Germany: treatment of costs for print files used for the production of labels

The German Fiscal Court of Hamburg decided on two connected customs valuation cases related to the treatment of cost for artworks realized in printing files for labels and clearing under the transaction value method with the existing of a condition. The key aspects of the cases and the messages of the court are outlined in the following.

## **I. Costs related to artworks for labels provided free of charge to the manufacturer by the German customer (Fiscal Court of Hamburg – case 4 K 177/16)**

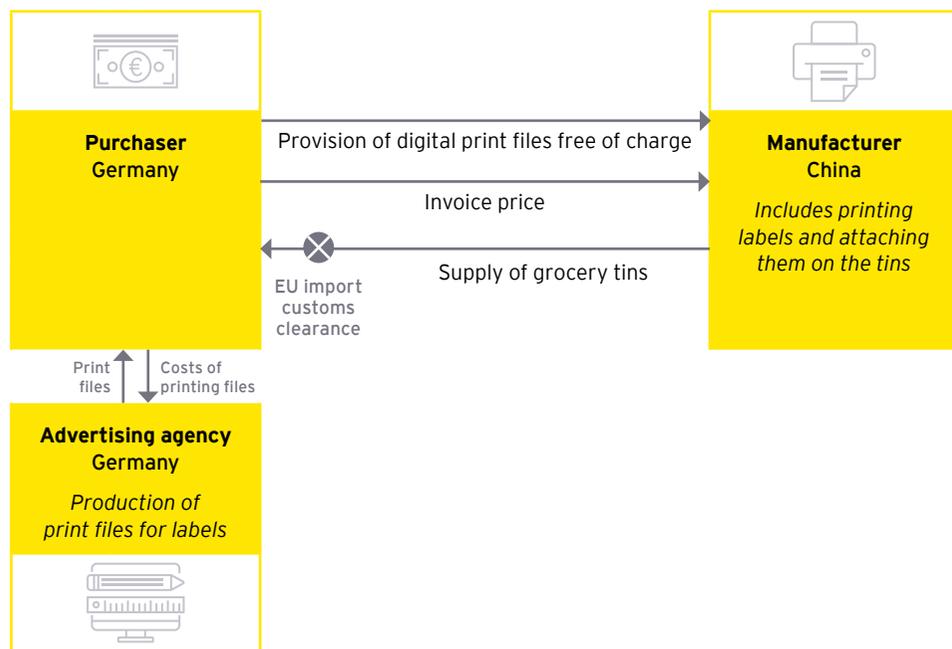
### **Background**

A company established in Germany bought food in tins from a Chinese manufacturer. In order to produce customer-specific sticker labels, the German buyer digitally provided print files for the layout of the labels free of charge to the Chinese supplier. The print files for the labeling had previously been produced by an advertising agency acting for the German buyer (who therefore incurred the design costs).

The German buyer acted as customs declarant for the tinned food when they were imported into Germany. The cost spent on the services provided by the advertising agency for production of the printing files for the labels was not added to the customs value. German customs authorities claimed that the cost must be added to the customs value. The importer argued that the print files are EU created and result from development activity, i.e., fall under the privilege of EU-created development that is not to be included into the customs



value of goods imported to the EU (Art. 71 (1)(b)(iv)). The customs authorities, in alignment with existing opinion in customs internal guidelines on customs valuation, objected to the administrative appeal so that the case was taken to Fiscal Court of Hamburg.



## Decision

The Fiscal Court decided that the costs for the printing files must be added to the customs value. It concluded for this case (4 K 177/16) that the tins are a type of packaging that is not just designated for transportation but in general is also used to store and sell the goods, which resulted in definition of the packaging as included in Art. 71 (1)(a)(iii)).

The sticker labels attached on the tins were concluded to be indivisible parts of the packaging, i.e., tins and labels were to be considered as one whole forming

the packaging. It was further noted by the court that tins (packaging) on which labels are attached constitute a different case compared to the customs valuation of other goods, such as hangtags or photo inlays.

The court summarized that Art. 71 (1)(a)(ii)<sup>1</sup> includes all cost that arose in relation to packaging of imported goods. The artworks created by the advertisement company (the printing file) in this respect was seen to have a direct relation to the imported goods.

The court outlined that there is no general privilege related to EU established development works. Solely development work undertaken within the EU customs territory that is used for the manufacture of the imported goods themselves is covered by Art. 71 (1)(b)(iv)<sup>2</sup>. In the present case, however, the cost arose in relation to development used for the sticker labels that form part of the imported goods' packaging. Hence, the customs valuation privilege does not apply. Therefore, the customs authorities won the case, since it was ruled that the cost must be added to the customs value in accordance with Art. 71 (1)(a)(ii).

## II. Costs related to artworks for labels acquired free of charge by the buyer and supplied to the manufacturer (Fiscal Court of Hamburg – case 4 K 148/17)

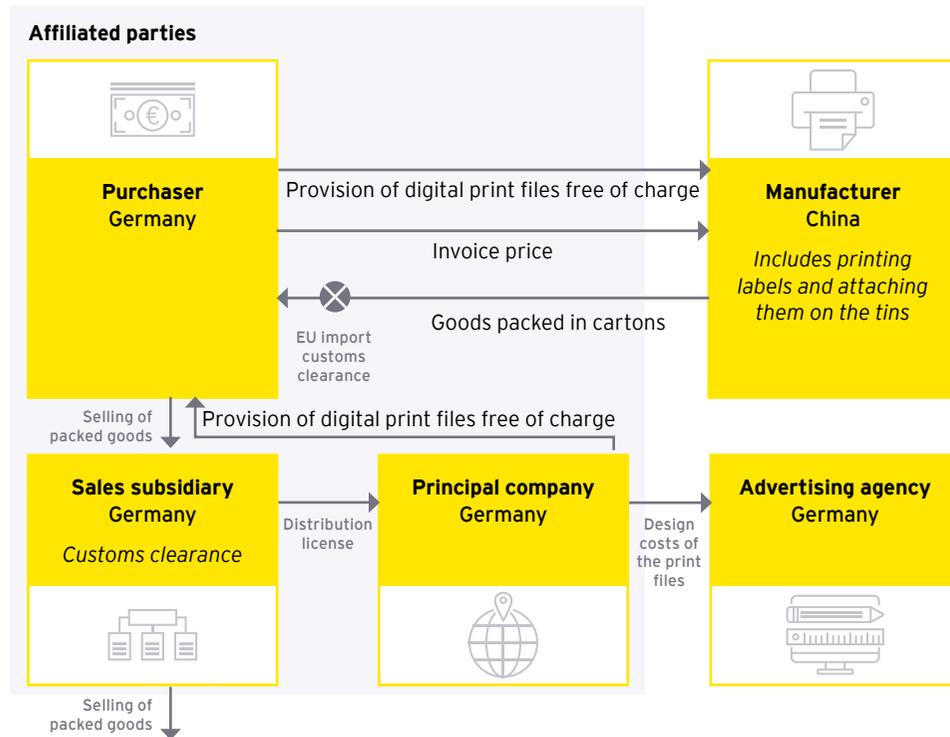
### Background

A German principal company assigned and paid an advertising agency to develop a printing file for labels that are attached to imported goods. The printing files were provided free of charge by the German principal to a related German established party buying food stuff packed in tins, which were manufactured by a Chinese company who was subsequently given the print file free of charge. As in the previous case, the print file was used to print labels, which were stuck onto the imported tins that served as retail packaging. The German buyer finally acted as importer and customs cleared the goods for release for free circulation. Subsequently, the goods were sold by the German importing company to an

<sup>1</sup> Art. 8(1)(a)(ii)

<sup>2</sup> Art. 8(1)(b)(iv).

inter-company sales company which, in turn, sold them to unrelated parties. The sales company paid distribution licenses for vending the foodstuffs to the related principal company. As in the previous case, the importer argued that the print files were the EU created result of development activity, i.e., fall under the privilege of EU-created development so that it should not be included in the customs value of goods imported to the EU (Art. 71(1)(b)(iv) (UCC)). The customs authorities, in alignment with existing opinion in customs internal guidelines on customs valuation, rejected the administrative appeal so that the case was taken to Fiscal Court of Hamburg.



**Decision**

The Fiscal Court decided that costs for the printing files must be added to the customs value, since the import transaction was subject to a value-driving condition.

In this case (4 K 148/17) the Fiscal Court of Hamburg concluded in the same way as in the case outlined above in relation to the customs valuation of the print files. However, in view of the differentiating facts in relation to the acting parties, the ruling includes the following additional conclusions.

The court followed the argument of the customs authorities that the value of imported goods was subject to a condition that resulted from the contractual and organizational set-up. The court argued that the principal company only provided the print files free of charge to the affiliated buyer purchasing from the Chinese manufacturer because the distribution chain within the group by its contractual and organizational set-up was arranged in a way that the imported goods must have been sold via the affiliated sales company, which was obliged to pay the distribution license.

It opined that the cost for the advertising agency borne by the principal was economically covered by the receipt of the distribution license fees paid by the affiliated sales company to the principal. Hence, the import transaction was concluded to be under condition of coverage of the costs for the advertising agency, which were settled as part of the distribution license fees paid by the sales company in the subsequent transaction. The value of the condition was established by the value of the principal's costs spent on the advertising agency.

**Implications**

Representatives of the German customs authorities' customs valuation office have highlighted these cases, commenting that situations like these occur quite often in practice and include costs for the provision of physical or immaterial assists free of charge or at a reduced price, such as payment for transport insurance by a group company for the whole group, etc. It is often not the company holding the import contract that either pays certain charges itself or has the information about the existence and/ or valuation of cost to be added to the customs value at hand. In many cases, costs that need to be added to



the customs value are paid by a designated party in the further supply and transaction chain. As a result, the contractual and/or organization aspects around the supply and transaction chain may either impose a valuable condition to the import transaction or in other cases may lead to denial of the use of the transaction value method at all, e.g., due to the existence of influences on arm's-length pricing in inter-company relationships where no valuation of the condition is possible.

It is often a practical challenge for the import declaring party to identify the existence of such costs, gather data for valuation and finally declare the relevant cost components to customs. While the recent Fiscal Court decisions do not stipulate any revolutionary change in legal opinion and, from a legal perspective, they are decisions related to single cases only, these decisions do confirm the current practice of the German customs authorities. Business operators should be aware of these cases and consider their possible impact, indicated by the courts' decisions to analyze current customs valuation set-up, since it can be assumed that this topic will be given greater focus in customs audits going forward.

Identification of assists, particularly ones that may be provided indirectly, can be challenging. As many situations are not documented in a manner in which the legal treatment is clear, it is important to gather and evaluate customs data, optimize future transactions by redesign of contracts, business, customs processes, and internal control system measures, and take remedial actions for any past violations where necessary. ■

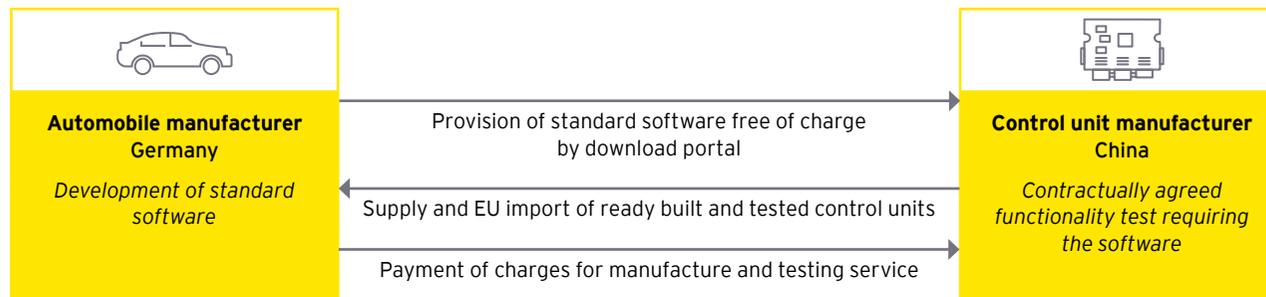
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# European Court of Justice: preliminary ruling request on customs valuation of software provides opportunity to file refund applications

The Fiscal Court of Munich has requested a preliminary ruling from the European Court of Justice (ECJ) in a customs valuation dispute involving a German automobile manufacturer and the German customs authority.<sup>1</sup>

The automobile company provided software free of charge through a portal to suppliers established in third countries who installed the software on controlling devices, which was specifically agreed by contract. The software was used by them to conduct testing to ensure the effective functioning of the unit devices. The software was created by the automobile manufacturer or by third parties. The controlling devices were subsequently imported into the EU and customs cleared for free circulation.



<sup>1</sup> Request for a preliminary ruling from the Finanzgericht München (Germany) on 4 July 2019 – BMW Bayerische Motorenwerke AG v Hauptzollamt München (Case C-509/19).



### **The German customs authorities' view**

German Customs expressed the view that the provision of the software free of charge is to be treated as a “regular assists” provision (comparable to physical assists) in accordance with art. 71 sec. 1 lit. b) (i) Union Customs Code (UCC). The German customs authorities opined that the software, in contrast to true nonmaterial assists, does not support the manufacturing process of the controlling device itself but adds significant value to the goods and enhances functionality. German Customs believe that the EU development work carried out to create the software may not be excluded from the customs value as design and development under art. 71 sec. 1 lit. b) (iv) UCC (Article 8, Section 1(b)(iv) of the WTO Valuation Agreement). Specifically, the exclusion allowed from the customs valuation for costs for EU development resulting in goods manufactured in third countries only covers developments, technical drawings, sketches and the like that are utilized in producing the product. The authorities base their view on Conclusion No. 26 of the customs valuation compendium of the EU, as well as the opinion of the Advocate-General in ECJ case C-306/04 dated 16 November 2006 (Compaq Computer International Corporation).

### **The questions referred**

The Fiscal Court has asked the ECJ whether the software may be treated as a “result of development” in accordance with art. 71 sec. 1 lit. b) (iv) UCC, and consequently excluded from the customs value of goods imported to the EU. The Fiscal Court did not specifically ask the question

whether a nonmaterial assist could be treated like a physical assist, but it follows from the Court's question to the ECJ that there is doubt on this point. It is clear from the Fiscal Court's question that the court realizes that the software is a key element that completes the production process and the functionality of goods contractually agreed for delivery, i.e., the software is essentially needed to conduct the contractually agreed functionality testing of the control units. Furthermore, it is seen that intellectual property created in the importing country (EU) shall be advantaged in comparison to intellectual property used for production of the imported goods that was created in third countries.

### **The automotive company's view**

The automotive company has supported its argument by pointing out that if the software would be treated as a material assist, there would be no possibility for using the customs procedure of outward processing. This results from the fact that the preliminary export is not about physical goods but only relates to software provided as download. Hence, there would be a significant disadvantage and unsystematic result, since EU local content would unavoidably become subject to import duty.

### **Implications**

This case has far-reaching implications in a number of sectors. Similar business and supply chain situations (that is, the integration of EU-created software into machinery/electronics in third countries and subsequent import of the goods to the EU) exist in several industries, not just in the automotive sector.

Businesses operating in Germany that have paid duty in similar circumstances may wish to act proactively to protect any possible refund applications that may arise if the automotive company wins this case. In situations where importers (customs declarants) have treated value components for EU-created software as additions to the customs value of imported goods, if the customs authorities imposed retroactive assessments, there is the opportunity to quickly file refund applications to secure legal rights and maintain a chance for refunds for the period that is not yet subject to the statute of limitation. Since the Union Customs Code forces the customs authorities to take a decision on these applications within the legally specified period (normally 120 days from acceptance of the application), there is no chance for suspension of the procedure. The authorities in Germany would, therefore, likely reject the refund applications so that an administrative appeal must be lodged. During the appeals procedure, it is possible (in Germany) to agree on suspension of the procedure until the ECJ case ruling is made and then, if the case and the details of the court's argument apply, agree on the application of the ECJ's opinion on the refund request.

Of course, it is currently unknown how the ECJ will decide the case and there are good arguments both for the automotive manufacturer's and customs authorities' positions; filing refund applications at this stage is a speculative investment. On the other hand, if a business identifies that a similar situation as described in the case exists and the cost for the EU developed software was not added to the customs value of imported goods, then the court decision should be monitored. If the ECJ decides



in favor of the customs authority, then importers should analyze and consult because – depending on the individual circumstances of the particular case – German tax law may require the customs declarant to proactively and without undue delay notify the competent customs authorities, in order to amend historic import customs declarations for which the statute of limitation has not yet occurred (leading to the retro-active assessment of import duty).

Either way, with the case pending, it is important for businesses to identify where they are involved in similar situations and collect the relevant data to establish to the extent of any potential refund claims or to prepare for remedial actions if their present treatment is inconsistent with the final ECJ decision. ■

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# Technology



Technology

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# Can data provide the trust to rewrite the terms of trade?

The global economy prospers when trade flows easily. But trade tensions, protectionist policies and regulatory uncertainty have pushed global trade into crisis. Established business models and relationships are breaking down. Systemic problems that have slowed the flow of trade for decades are making the situation worse, and it is harder for organizations to respond. We believe it's time for trade to transform.

Better data and smarter technologies have revolutionized just about every corner of organizational life, yet when it comes to global trade, that's not the case. From finance, to shipping to logistics, too much still depends on remarkably primitive processes despite the huge flows of money and goods involved.

Sometimes that's because the organization's own systems are not sufficiently automated. Other times it's because they're participating in a network of trade relationships where key players have not invested in better technology.

As a consequence, organizations are forced to work with data around trade that is often incomplete and unreliable. It comes from multiple sources and is frequently contradictory, or plain wrong. Mistakes occur. Governments don't collect the right amount of tax. Companies don't take full advantage of free-trade agreements that are meant to benefit them and encourage commerce.

When data can't be trusted, it can't be used to drive better business decisions. This is painfully frustrating for leaders. They want to set a strategic direction for their organization, but they are too often forced into actions that are rushed and tactical because they don't have a comprehensive and reliable view

of what's really going on. And this lack of trust spreads like a virus. It creates friction, cost and risk across connected trade networks. It discourages collaboration and innovation. It creates acute economic uncertainty. And it slows progress toward better ways of working.

## Trade has reached a tipping point

For some time now, inefficiencies in trade networks have been accepted as a cost of trading globally. But they are fast becoming unacceptable.

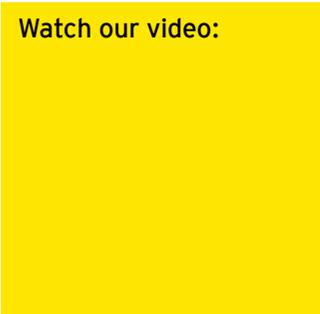
Take the example of an auto manufacturer that ships engines made in Spain to South Africa for assembly. It should take two days for a consignment to make the journey. However, the business adds a half-day buffer because delays in transit are common. Perhaps on arrival at port the bill of lading is incomplete, the customs declaration is wrong or the country of origin can't be established properly.

The buffer to accommodate delay adds cost, but the alternative – stopping the assembly line because the engines haven't arrived – is unthinkable.

This way of working can cost a typical auto manufacturer billions of dollars a year. At a time when tariffs, regulations, trade deals and political relationships are relatively static, it's a cost that could be absorbed. But in a time of crisis, when a government can change its established trade policy in the blink of an eye, the stakes are far higher. The cost, risk and uncertainties created by the way trade works today have become intolerable.



Watch our video:



## Where is the technology revolution?

It's ironic: we're facing a trade crisis, just as we ought to be entering an exciting new era of global trade.

Across industries and sectors, innovations such as advanced data analytics, blockchain and artificial intelligence are creating new opportunities and transforming what's possible. That's pushing leaders to challenge core assumptions about what they do, how they do it and why their organization even exists.

We should be as disruptive and innovative when thinking about technology for trade. The impact of technologies that enable people to trust and act on data could – and should – be as revolutionary as the introduction of the shipping container.

This isn't simply about removing cost and delay, or improving financial performance. When organizations trust their trade data, they can use it to transform their operations and unlock value more widely.

For example, they could meet their obligations in relation to climate change more effectively, play a constructive role in combating problems such as human trafficking and create sustained, long-term value for all their stakeholders.

## How do we move forward?

Looking to the future, trusted data will only become more important. We believe that the way organizations create value is changing. Whatever industry or sector you are in, your ability to succeed will be shaped by your ability to play in collaborative ecosystems that generate value for all their participants. Trusted data isn't just the price of admission; it's the glue that holds these ecosystems together and enables them to flourish.

So, what now? There are immediate actions that any organization can take now to help them respond better to the crisis we face today, and position them for the future.

### 1. Build an integrated perspective on trade

Trade issues typically fall into organizational silos, so there is rarely an individual or team setting strategic direction or taking overall responsibility. The result is increased cost and risk. This has to change.

If you bring together the key people with a stake in trade – from compliance and supply chain to finance and tax – and give them data insights they trust, they can start to form a comprehensive view on the way dynamic regulations and other market changes are impacting their business. The creation of a virtual trade team breaks down siloes to facilitate the sharing of information and empowers people to make decisions based on a data-informed view of what will create or protect value.

### 2. Shape a coherent response

With a comprehensive and data-informed overview of what's going on, this group can move away from tactical, reactive actions and begin shaping a proactive trade strategy including a more coherent response to a dynamic global regulatory environment. The team will be able to identify the potential impact of changing conditions and requirements, and respond faster.

An active approach to changing global tariffs and trading relationships could provide savings opportunities through strategic sourcing, shifting manufacturing locations and implementing duty planning strategies like Free Trade Agreement utilization, while retaining trade compliance.

### 3. Drive efficiencies in your trade network

With an integrated perspective, organizations can anticipate supply chain problems, identify their causes and drive ongoing efficiencies across their trade network. That means they can quickly respond to change, eliminate costs, accelerate their speed to market, become more competitive and develop more agile business models – without jeopardizing regulatory compliance.

Gain greater visibility means organizations can optimize trade flows as products move along the supply chain to assess performance and identify opportunities. For example, this could include improving stock level management to increase compliance through better monitoring, reducing carrying costs by optimising stock levels and customs clearances, and better customer service fulfilment.

### 4. Drive smarter use of better data

As better data starts to drive smarter decisions, there's value in organizations building robust data management systems. These need to extend beyond functional silos and allow full participation in wider, data-driven trade networks.

Such systems will enable organizations to gather, cleanse and consolidate all the trade data they need. They will have access to data analytics that provide key trade insights. And they will convert those insights into comprehensive, up-to-date business intelligence that will allow leaders to make informed decisions that improve the business today and position it for success tomorrow. This could include using data analytics to identify duty savings opportunities through the end-to-end supply chain, improve visibility to identify potential compliance gaps and use trusted trader programs to validate compliance.

### 5. Commit to disruptive technology with confidence

A more comprehensive perspective on trade provides a much clearer view of which disruptive technologies will help organizations achieve their long-term strategic goals. Benchmarking against what competitors are doing, what technology is available and understanding the legacy system impact and integration can create a disruptive technology roadmap. This allows organizations to then invest in the technology innovations that will drive competitive advantage, integrated into their wider plan for digital transformation.

Everyone benefits when trade works better. The shift from the slow and inefficient trade networks we see today to the collaborative, data-informed ecosystems of tomorrow built on trusted intelligence is an opportunity for innovation. Leaders who work to shape that future can secure their place in the new era of global trade.

### Summary

The world's current political and regulatory climate has pushed global trade toward a state of crisis. At the same time, we're entering a breakthrough era where data and technology are fundamentally changing the way trade is conducted. What was once impossible is now becoming reality. Organizations need to have trust at the core of their global trade plans to better respond to challenges and secure their place in this new era of trade. ■

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# Digitize the road map to become an AEO?

**It has been more than 10 years since the AEO program was introduced in the EU Customs Union (Union).**

The AEO program has become an important pillar to encourage trade operators to enhance international supply chain security and to contribute to legitimate trade. The EU program covers authorizations for customs simplifications (AEOC), security and safety (AEOS) or a combination of both. Trade operators obtaining the AEO status have the obligation to continuously meet the AEO compliance requirements and, in return, are entitled to benefit from several trade and/or safety facilitations within the Union. In respect to these compliance requirements, it is noticeable that AEO applicants face more challenges in obtaining the AEO status nowadays.

- ▶ Since the Union Customs Code (UCC) became applicable on 1 May 2016, additional requirements and new criteria have been introduced to qualify for an AEO authorization (instead of obtaining an AEO certificate). In general, it is increasingly difficult for applicants to pass the assessment by the customs authorities, as the standards being applied are more stringent compared to the past. Overall, there are higher expectations in terms of internal controls and monitoring, with applicants expected to reinforce procedures for internal verification, internal audit, accountability and continuous improvement.

- ▶ Further, digitalization is playing a much greater role today. Customs authorities are more demanding that operators manage and report their global trade activities real time and electronically, forcing them to modify their organization of (AEO) compliance.

## Benefits of being an AEO

The different types of AEO authorizations offer trade operators several and exclusive advantages.

- ▶ An AEOC facilitates the operators' eligibility and usage of various simplifications and authorizations provided for under EU Customs legislation. Sometimes the AEOC status is required to have access to particular authorizations.<sup>1</sup> Operators holding the AEOC status could benefit from a more favorable treatment in respect of customs controls (e.g., fewer physical and documents-based controls, priority treatment), which allows the operator to mitigate the risks of supply chain disruption or volatility.

<sup>1</sup> Examples in this respect are the admittance to the authorizations for *Centralized Clearance* and the *Entry in the Declarant's Records*.



- ▶ An AEOS is envisaged for trade operators who would like to benefit from particular facilitations related to security and safety controls in respect to goods entering or leaving the Union. An additional advantage for operators having the AEOS authorization is mutual recognition. Several other customs jurisdictions recognize AEOS, allowing the operators to be eligible for certain safety facilitations in those jurisdictions as well.

Operators having the AEO status are generally considered by other stakeholders to be reliable partners in global trade and security. An emerging trend is that AEOs prefer doing business with other

operators holding the AEO status. This will speed up the supply chain, minimize the risk of delays or supply chain disruptions and, eventually, contribute to reduce costs. Therefore, even if a business operates at high compliance levels, the absence of an AEO authorization may have a negative effect on the supply chain partners and the perception of customs authorities globally.

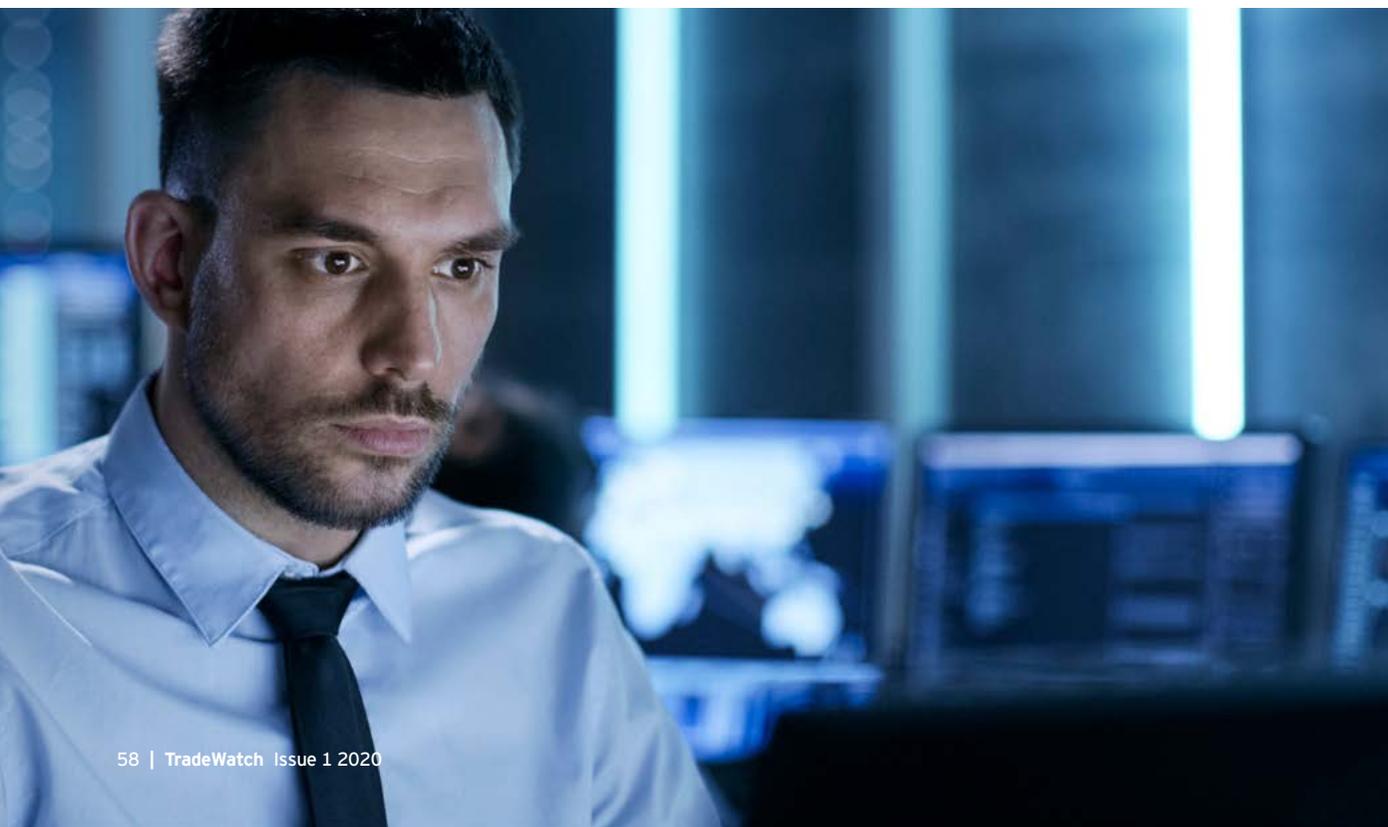
### **Preparations to become an AEO**

Preparation of the AEO application is a time-consuming process. Thorough preparation is key in this respect. Trade operators should show the

competent customs authorities that, depending on the type of AEO authorization applied for, their business activities and their operating models, they have adequate internal procedures and internal controls in place to manage the AEO compliance. Further, operators must monitor and document the results of those internal controls to ensure those procedures work properly.

As part of the preparations, operators are obliged to complete an AEO Self-Assessment-Questionnaire (SAQ). The AEO Guidelines provides a standard SAQ that is generally adopted and used by the Member States.<sup>2</sup> The purpose of the SAQ is to support applicants' understanding of the requirements associated with obtaining and, eventually, maintaining the AEO status. Operators can use the completed questionnaire to assess whether their current organization of the trade and/or safety compliance needs to be modified to meet AEO standards.

Generally, the SAQ shall be submitted together with the application for an AEO authorization to the competent customs authorities. During the application process, the customs authorities audit the design, the existence, and the implementation of procedures and internal controls. The completed SAQ can be a valuable resource to assess the AEO compliance level.



<sup>2</sup> European Commission, 11 March 2016, AEO Guidelines, Annex 1, TAXUD/B2/047/2011 – Rev.6

It should be noted that the AEO Guidelines are not legally binding, and that Member States, based on national legislation, might deviate from the practice described above, i.e., in terms of form and content of information to be provided and/or the application method.<sup>3</sup>

### AEO Readiness Scan

EY teams have developed a digital solution, the AEO Readiness Scan, that allows trade operators to assess whether their current level of trade and safety compliance meets the AEO requirements before customs authorities get involved. The scan covers all activities that should be carried out in the preparations and application for the AEO authorization. Applicants benefit from a more transparent and efficient application process by using this scan.

The AEO Readiness Scan contains an extensive questionnaire that applicants should complete. The questionnaire is based on requirements set forth in both EU Customs legislation and the directives provided in the AEO Guidelines, and it is similar to the standard SAQ from the Guidelines. Because these questions cover a broad range of topics (e.g., IT, HR, safety, security, finance), sections of the questionnaire can be assigned to subject-matter resources within the company.

The applicant's answers to the questionnaire generate a rating per question. Subsequently, this rating, together with the other ratings associated with questions in the same (sub)section is translated into a weighted average per (sub)section. The ratings are predetermined by EY professionals and correspond to a certain risk indicator. Ratings vary on a scale from zero to five, where zero hints to poor compliance and five reflects a leading practice scenario.

All ratings are compressed and displayed in management dashboards (using Power BI) and a report. These help enable applicants to easily estimate their current AEO compliance level by seeing which compliance activities are highly developed within the company and which elements require attention. The customs authorities are not involved in the application procedure yet, allowing applicants to work on remediation plans to mitigate any observed compliance gaps.

The digital solution is also able to automatically prefill all documentation needed for the AEO application (e.g., application form, (summary) SAQ, management statement for the AEO application). ■

<sup>3</sup> E.g., in the Netherlands, it is required to fill in the standard SAQ, however, it is not obliged to include the completed SAQ in the AEO application. Instead, the application should contain a Summary AEO Self-Assessment form that shows the results of the completed SAQ performed by the applicant by means of scores between 0 to 5 (i.e., leading practice), without any supporting documentation



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# The power of technology in global trade: webcast series

On Wednesday, 22 January 2020, the EY Global Trade team hosted the first in a series of webcasts on the power of technology in global trade. They explained current key issues and trends on this topic, alongside some innovative technology demonstrations to show how analytics can support your business in the most efficient, agile and cost-effective way. The webcast recording is available [here](#).

EY Global Trade will be running a series of webcasts over the next few months to highlight the complexities and solutions for specific customs and global trade related topics, including the following:

- ▶ **The power of technology in Global Trade** – this session will cover using trade data to optimize trade flows, assess compliance risks, identify trends, broker performance/accuracy, supply flows, supplier oversight, product classification/value/origin errors much more.
- ▶ **Tariff Classification of products, Analytics and Machine Learning** – classification is a key, legal requirement for customs declarations. We discuss how analytics can assist and simplify this process.

- ▶ **Origin and technology services** – origin calculations, evidencing that Rules of Origin are met and having effective origin management systems, will become ever more important for accessing reduced or nil duty rates under free trade agreements (FTAs). This will be particularly important regarding a potential future FTA between the UK and the European Union. Analytics can significantly simplify and speed up this process. This session will discuss recent changes in UK and Global FTAs and how analytics can assist in planning going forward.
- ▶ **Trade tensions, scenario modelling and mitigation planning** – trade tensions are adding both cost and complexity to many supply chains. Understanding the impact and options for mitigation will be key for successful businesses going forward. This session will examine the recent events in the global arena and discuss how analytics may assist in the analysis and forward planning.
- ▶ **Global Trade Management (GTM) software solutions** – this session will discuss the developing use of GTM solutions in the UK today and the

range of software available to match different requirements. This may include making your own customs declarations and also managing duty relief schemes (track and trace of goods, etc).

Details of the upcoming webcasts will be published via our [Global Tax News Update](#). ■



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# Tax Alerts

Tax Alerts

## Americas

**Argentina**

- ▶ Argentina makes sweeping changes to tax laws, followed by regulations implementing recently enacted tax reform (08.01.2019)
- ▶ Argentina enacts tax reform (24.12.2019)
- ▶ Argentine tax reform bill sent to Congress (19.12.2019)

**Canada**

- ▶ Canada again begins Canada-US-Mexico Agreement (CUSMA) ratification (05.02.2020)
- ▶ Canada: 2020 customs compliance verification list update (17.01.2020)

**Colombia**

- ▶ Costa Rica-Colombia Free Trade Agreement: FTC issues decision on validity of Certificate of Origin (18.10.2019)

**Costa Rica**

- ▶ Costa Rica's General Directorate of Customs publishes resolution on the Customs Declaration Message Format (15.01.2020)
- ▶ Costa Rica's General Customs Directorate publishes resolution amending the Customs Procedures Manual (16.12.2019)
- ▶ Costa Rica's General Customs Directorate publishes resolution amending the Customs Procedures Manual (13.11.2019)
- ▶ Costa Rica's General Customs Directorate publishes draft amendments to Article 457 of the General Customs Law regulations (04.11.2019)
- ▶ Costa Rica-Colombia Free Trade Agreement: FTC issues decision on validity of Certificate of Origin (18.10.2019)

**Honduras**

- ▶ Honduras further extends amnesty program (16.01.2020)

**MERCOSUR**

- ▶ MERCOSUR decision allows goods to retain origin quality when passing through a free trade zone (14.10.2019)

**Nicaragua**

- ▶ Nicaragua's General Directorate of Customs affirms exclusive right of Cargo Transport Cooperative to register the Central American Single Declaration on behalf of third parties (24.01.2020)

**OECD**

- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)
- ▶ Officials discuss OECD BEPS 2.0 project at DC Conference (19.12.2019)

**Uruguay**

- ▶ Uruguay's Ministry of Economy and Finance announces tax benefits for certain economic sectors (13.12.2019)

**US**

- ▶ US imposes new trade sanctions on Iran (30.01.2020)
- ▶ US imposes additional tariffs on derivative articles of steel and aluminum; 17 member countries agree to interim remedy to WTO dispute settlement process (29.01.2020)
- ▶ US and China sign Phase One Economic and Trade Agreement though tariffs remain (16.01.2020)
- ▶ USTR issues amendments to granted exclusions to Lists 1 and 2 for Chinese-origin goods; grants new exclusions to List 3 (19.12.2019)
- ▶ US and China reach Phase One Agreement on trade (16.12.2019)
- ▶ USTR proposes new tariffs on EU under Section 301; WTO Appellate Body set to disband (11.12.2019)
- ▶ US issues findings of Section 301 investigation regarding France's Digital Services Tax; proposes imposition of tariffs (04.12.2019)
- ▶ USTR announces various actions related to exclusion processes for China origin goods covered under trade remedy actions and initiates revisions for future exclusion requirements; US continues to evaluate certain country eligibility benefits under GSP (01.11.2019)
- ▶ US and China reach initial accord towards trade agreement on agricultural purchases, tariff delays and next steps on framework for intellectual property and technology transfers (14.10.19)
- ▶ US and Japan formalize initial Trade Agreements, effective 1 January 2020 (14.01.2020)

Americas

Tax Alerts

# Asia-Pacific and Japan

## China

- ▶ China adjusts certain 2020 commodity import tariff rates (06.02.2020)
- ▶ US and China sign Phase One Economic and Trade Agreement though tariffs remain (16.01.2020)
- ▶ USTR issues amendments to granted exclusions to Lists 1 and 2 for Chinese-origin goods; grants new exclusions to List 3 (19.12.2019)
- ▶ US and China reach Phase One Agreement on trade (16.12.2019)
- ▶ USTR announces various actions related to exclusion processes for China origin goods covered under trade remedy actions and initiates revisions for future exclusion requirements; US continues to evaluate certain country eligibility benefits under GSP (01.11.2019)
- ▶ US and China reach initial accord towards trade agreement on agricultural purchases, tariff delays and next steps on framework for intellectual property and technology transfers (14.10.19)

## Japan

- ▶ US and Japan formalize initial Trade Agreements, effective 1 January 2020 (14.01.2020)

## OECD

- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)
- ▶ Officials discuss OECD BEPS 2.0 project at DC Conference (19.12.2019)

Asia-Pacific and Japan

Tax Alerts

# Europe, Middle East, India and Africa

## Algeria

- ▶ Algeria enacts 2020 Finance Act (22.01.2020)

## Dominican Republic

- ▶ Dominican Republic's National Council of Free Trade Zones of Exportation modifies VAT exemption card validity period (21.01.2020)

## EU

- ▶ Brexit: UK HMRC provides guidance to EU businesses and removes opportunity for advance VAT registrations (29.01.2020)
- ▶ USTR proposes new tariffs on EU under Section 301; WTO Appellate Body set to disband (11.12.2019)
- ▶ EU Member States to require new EORI number for UK/North Ireland businesses under no-deal Brexit: German customs update (29.10.2019)

## France

- ▶ US issues findings of Section 301 investigation regarding France's Digital Services Tax; proposes imposition of tariffs (04.12.2019)

## Ghana

- ▶ Ghana enacts various tax amendments (03.02.2020)
- ▶ Ghana presents 2020 Budget Statement and Economic Policy (19.11.2019)

## Iran

- ▶ US imposes new trade sanctions on Iran (30.01.2020)

## Italy

- ▶ Italy's Digital Services Tax enters into force as of 1 January 2020 (17.01.2020)
- ▶ Italy introduces proportional tax on plastic items (15.01.2020)
- ▶ Italy approves 2020 Budget Law (09.01.2019)
- ▶ Italy to introduce proportional tax on plastic items (21.11.2019)

## Kenya

- ▶ Kenya Revenue Authority issues guidelines on implementation of recent legislative changes to Import Declaration Fee and Railway Development Levy (01.01.2020)
- ▶ Kenya Revenue Authority announces 13 November 2019 as commencement date for Excisable Goods Management System (05.11.2019)

## OECD

- ▶ OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two (07.02.2020)
- ▶ OECD announces renewed commitment of participating countries to reach consensus on new international tax rules under BEPS 2.0 project in 2020 (03.02.2020)
- ▶ Officials discuss OECD BEPS 2.0 project at DC Conference (19.12.2019)

## The Netherlands

- ▶ Dutch Customs postpones requirement that non-EU company can no longer act as exporter from The Netherlands until 1 April 2020 (26.11.2019)
- ▶ Dutch Customs announces that non-EU company can no longer act as exporter from The Netherlands as of 1 December 2019 (18.10.2019)

## Turkey

- ▶ Turkey imposes recycling contribution fee (21.01.2020)

## UK

- ▶ Brexit: UK HMRC provides guidance to EU businesses and removes opportunity for advance VAT registrations (29.01.2020)
- ▶ UK Conservative Party wins clear majority in General Election: implications for Brexit and tax policy (13.12.2019)

## Zambia

- ▶ Zambian Government issues 2020 Tax Amendment Acts (21.01.2020)

Europe, Middle East,  
India and Africa

Tax Alerts

# Additional resources



## Global trade disruptors

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

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## 2019 EY Global Trade Symposium report

*Focusing on fundamentals* – a global trade leading practices briefing

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## Brexit: read our latest analysis

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

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## Global trade on ey.com

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Additional resources



## Managing indirect tax evolution

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

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## Tax Insights

EY's latest Tax Insights for business leaders.

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## Global Tax News Update

With EY's Tax News Update: Global Edition (GTNU) subscription service, you'll enjoy access to the same updates that are distributed each day within the EY Tax practice. Choose the topical updates you want to receive across all areas of tax (corporate, indirect, and personal), the jurisdictions you are interested in, and on a schedule that's right for you.

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## Americas Indirect Tax Symposium

The 2020 Americas Indirect Tax Symposium will take place in Hollywood, Florida from 20-21 February 2020. The Symposium will focus on global indirect taxes and will delve into topics specific to the Americas, including global trade. Our panelists and keynote speakers will focus on how businesses can adapt and thrive in the complex indirect tax regulatory environment in the Americas.

[For further information please email](#)



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*EY EMEIA Global  
Trade Partner*



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