

TradeWatch



EY Global Trade

Issue 1 2021



Building a better
working world

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EU and China: The Comprehensive Agreement on Investment

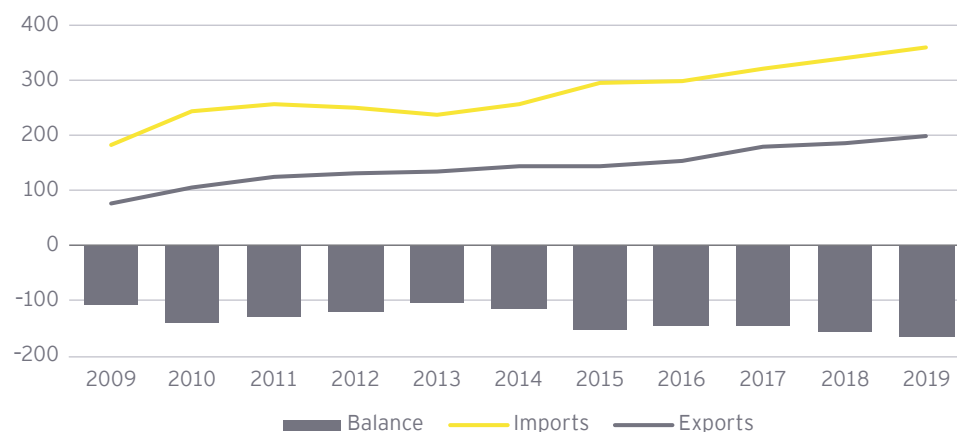
Background

Mainland China (China) and the European Union (EU) are important trading partners, with China being the EU's biggest trading partner – surpassing the United States (US) in trade with the EU in September 2020 – and the EU being China's biggest trading partner.

According to statistics released by Eurostat, trade volumes have significantly increased between 2009 and 2019:¹

- ▶ EU exports to China: from EUR77 billion (2009) to EUR198 billion (2019)
- ▶ EU imports from China: from EUR185 billion (2009) to EUR361 billion (2019)

EU trade in goods with China, 2009-2019 (EUR billion)



Source: Eurostat



Doing business in China

Doing business in China is sometimes seen by foreign companies as complex and traditionally associated with many restrictions. Examples include restrictions in the following areas: market access, government control, foreign exchange rules, legislative/judicial system, competition with state-owned enterprises (SOEs), intellectual property rights protection and government subsidies/state aid.

However, many EU companies still want to do business in China as it is one of the largest and fastest-growing economies in the world, with a domestic market of more than 1.4 billion consumers.

Due to the attractiveness of both markets – but, more importantly, the significant increase in trade volumes (and in foreign direct investment (FDI), which increased at the same time) – both trading partners want to provide companies on both sides with predictable, long-term access to one another's markets and to protect investors and their investments.

¹ "China-EU – international trade in goods statistics," Eurostat website, accessed 6 January 2021. [Find it here](#)

Comprehensive Agreement on Investment

In 2012, the EU and China agreed to launch negotiations for the Comprehensive Agreement on Investment (CAI) between the EU and China. In December 2020, after 34 rounds of negotiations, the EU and China finally concluded in principle the negotiations, and both parties committed to working toward the ratification of the CAI.

The European Commission Executive Vice-President and EU Commissioner for Trade, Valdis Dombrovskis, said:²

“This deal will give European businesses a major boost in one of the world’s biggest and fastest-growing markets, helping them to operate and compete in China. It also anchors our values-based trade agenda with one of our largest trading partners. We will engage closely with China to ensure that all commitments are honored fully.”

What are the main benefits of the CAI for EU companies?

According to the European Commission, the rules negotiated in the CAI set a high benchmark in terms of transparency, level playing field, market access commitments and sustainable development. The main benefits of the CAI for EU companies are market access commitments by China and the opportunity to help level the playing field for EU companies in China, both of which are discussed below.

Market access commitments by China

The EU has negotiated further and new market access openings and commitments such as:

- ▶ The elimination of quantitative restrictions (such as limiting the number of licenses or branches, reserving monopoly rights or imposing economic needs test)
- ▶ Foreign equity caps
- ▶ Joint venture requirements in a number of industry sectors

These are key restriction areas that make doing business in China complex and difficult, as noted above.

The European Commission published a memo³ highlighting the key elements from the CAI and provided examples of market access commitments by China for the following industries.

- ▶ Manufacturing
- ▶ Automotive (incl. new energy vehicles)
- ▶ Financial services
- ▶ Health care (private hospitals)
- ▶ R&D (biological resources)
- ▶ Telecommunication/cloud services
- ▶ Computer services
- ▶ International maritime transport
- ▶ Air transport-related services
- ▶ Business services
- ▶ Environmental services
- ▶ Construction services

Opportunity to help level the playing field for EU companies in China

China needs to ensure that state-owned enterprises (SOEs) take decisions solely based on commercial considerations and not to discriminate against EU companies in their purchases and sales of goods or services. China needs to share information and consult the EU if the behavior of SOEs negatively impacts EU investors.

The CAI includes a prohibition of investment requirements that compel transfer of technology (e.g., to a joint venture partner), no interference in contractual freedom in technology licensing and disciplines on the protection of confidential business information collected by administrative bodies.

The EU and China also agreed on the transparency obligations on subsidies provided in the services sector and commitment from China to share information and to consult on specific subsidies that could have a negative effect on the investment interests of the EU.

The CAI will also include a comprehensive set of transparency rules for regulatory and administrative measures enhancing legal certainty and predictability, as well as rules on procedural fairness and the right to judicial review, including in competition law cases.

² “EU and China reach agreement in principle on investment,” *European Commission website*, accessed 6 January 2021. [Find it here](#).

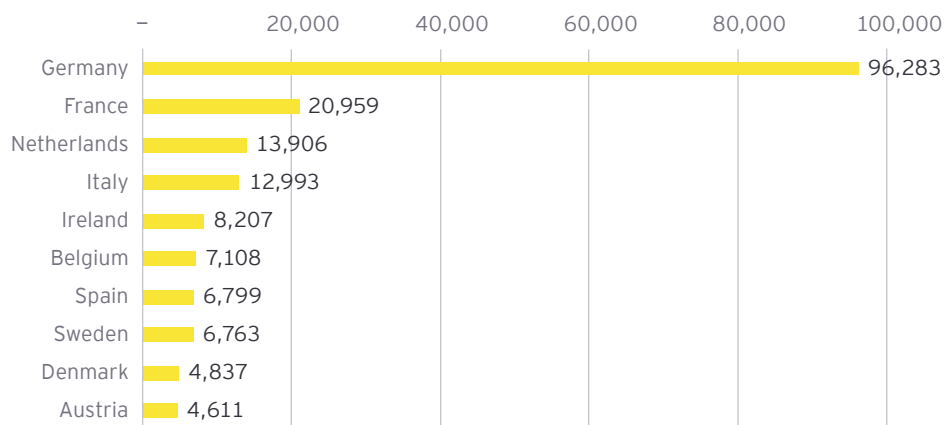
³ “Key elements of the EU-China Comprehensive Agreement on Investment,” *European Commission website*, accessed 6 January 2021. [Find it here](#)

Overall, the CAI will provide for a formal and binding framework to discuss and address concrete problems EU investors face in China as well as dispute resolution if China does not comply with its CAI obligations.

From a global trade perspective, companies established in Germany, France, the Netherlands and Italy will most likely benefit the most from the CAI. The four countries together account for almost 75% of the EU's total exports of goods to China.

It is worth noting that about half of EU FDI in China is in the manufacturing industry sector, with the German automotive industry as the main investor.

EU (top-10) export of goods to China (EUR billion)



Source: Eurostat

Impact on trade and supply chains

Free Trade Agreement

The CAI is not a free trade agreement (FTA) like the EU-Vietnam FTA, which entered into force on 1 August 2020,⁴ and thus does not eliminate customs duties for China originating goods imported into the EU, or vice versa for EU originating goods imported into China.⁵

Although an investment agreement in principle can be a step toward an FTA, the EU Commission clearly stated in its questions and answers (Q&A) section on the CAI that there currently is no authorization from the Council of the EU to negotiate an FTA with China.⁵

As such, from a global trade perspective, not much will change. There will still be customs duties and the normal customs formalities on both sides of the customs border, such as filing an import declaration, declaring origin, and preparing the commercial invoice and related transport documents will remain in place.

However, with the CAI contributing to fairer competition on the China market, it should have a favorable effect on the confidence of EU investors. This also follows from a 2020 survey published by the European Union Chamber of Commerce in China (the Chamber).⁶ From the survey, it can be concluded that if greater Chinese market access were to be granted, 62% of the members of the Chamber would be more likely to increase their investment in China. Investment often tends to increase trade flows (imports and exports).

Broader supply chain

In recent years, geopolitical pressures have resulted in additional customs duties for sales of certain goods from China to the US and restricted trade in technology goods. The COVID-19 pandemic has reinforced some of these trends, and the topic of potentially decoupling the China supply chain – from the US or the rest of the world – has been added to the C-suite agenda.

Diversifying the manufacturing footprint, however, is complex, and there are many considerations with respect to changing it. To name just a few, companies must:

- ▶ Find the right location
- ▶ Hire skilled labor
- ▶ Assess available infrastructure
- ▶ Consider entry/exit strategies
- ▶ Address taxation
- ▶ Forego agreed incentives

⁴ Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam, OJ L 186/3, 12.6.2020, p. 3-1400

⁵ "Q&A: EU-China Comprehensive Agreement on Investment (CAI)," *European Commission website*, accessed 6 January 2021. [Find it here](#)

⁶ "Business Confidence Survey 2020: Navigating in the Dark," *European Union Chamber of Commerce in China website*, accessed 6 January 2021. [Find it here](#)



Aside from the above, decoupling could be very disruptive, requires capital and results in the loss of access to certain key suppliers.

The CAI could potentially play a role here as well, especially in light of the *Business Confidence Survey 2020* discussed above – increased investment in China if greater Chinese market access were to be granted.

For EU companies, this could mean changes to the C-suite agenda that result in slowed activity or even full reconsideration of decoupling the China supply chain.

Another recent development, the Regional Comprehensive Economic Partnership (RCEP),⁷ signed on 15 November 2020, should be taken into account from a broader supply chain perspective.

RCEP will cover around 30% of the world's GDP and population, making it the largest trade agreement by these measures. It also is the first trade agreement among China, Indonesia, Japan and South Korea, four of the five largest economies in Asia.

RCEP aims to reduce or eliminate customs duties imposed by each member state on originating goods by approximately 92% over a period of 20 years. One major advantage under RCEP is that it allows for origin cumulation.⁸

The combination of CAI and RCEP, which are both expected to enter into force around the same time, can open possibilities for (re)optimizing Asian supply chains. For example, China's deep and efficient supply networks may be combined with downstream activities in other RCEP member states, resulting in utilizing FTAs the EU has in place with RCEP member states (e.g., Vietnam, as mentioned earlier), and potentially qualifying for non-China origin if the goods are exported to the US market.

Hence, the broader impact of the CAI – in conjunction with RCEP – should be considered in the supply chain strategies of EU companies, especially those that have manufacturing footprints in China producing goods not only for the EU market, but also for other markets in Asia or globally.

⁷ RCEP member states are Australia, Brunei, Cambodia, China, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, South Korea, Thailand and Vietnam. At the time of this writing, the RCEP had not yet been ratified.

⁸ The RCEP cumulation is a provision that allows considering goods obtained in, or with processing taking place in, one of the member states as originating in another. Cumulation enables production sharing among the 15 member states. This is one way to provide companies with a greater flexibility in terms of sourcing inputs and parts: it allows use of inputs and parts from suppliers located in member states and treats them as originating for the purpose of determining the origin of the final product.

⁹ "EU China Relations," *European External Action Service website*, accessed 6 January 2021. [Find it here](#)

What's next?

The CAI will have to be ratified by both sides to take effect. On the EU side, it will have to be ratified by the European Parliament (there is no need for ratification by the national parliaments of the EU Member States), which is aiming for the agreement to take effect in early 2022.

However, there are still a few final sticking points to be determined: (i) the conclusion of negotiations on an additional investment protection agreement, (ii) commitments on environment and climate and (iii) the EU securing commitments that China will work to ratify and implement International Labor Organization conventions.

For the EU, in the next few years, China will simultaneously be a cooperation partner, a negotiation partner, an economic competitor and a systemic rival, depending on the policy area in question.⁹ How this will influence the political and trade agenda of the two trading powers remains to be seen. ■

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Exclusive distribution rights: Court decisions illustrate the need for careful planning



A customs valuation strategy to separate exclusive distribution rights (EDR) from the dutiable value of imported products is in the news again; this time, as a result of a Court of Justice of the European Union (CJEU) decision in *5th Avenue Products Trading GmbH (5th Avenue)* (Case C-775/19) finding the importer's attempt at separation ineffective and determining the amounts paid for EDR dutiable. The 5th Avenue decision demonstrates that this strategy may not always achieve the intended outcome and serves as a caution regarding how the specific facts of a case may be viewed in different jurisdictions.

The concept

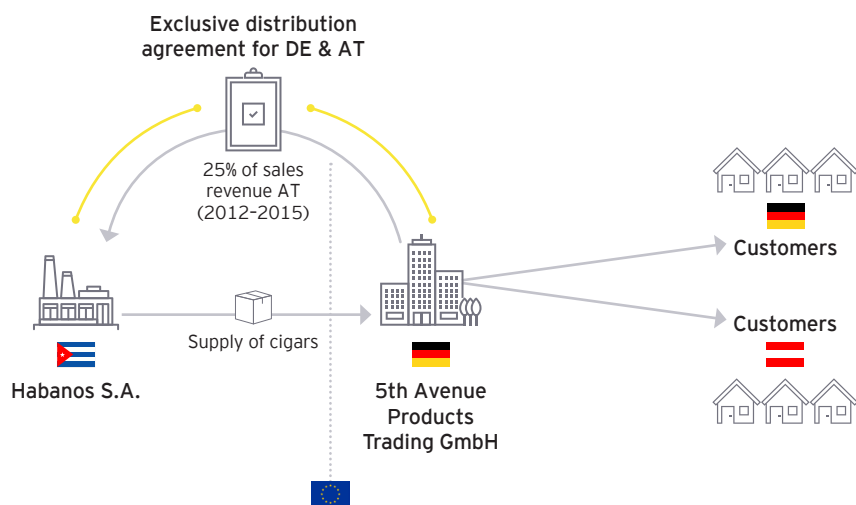
While the right to re-sell a product is inherent in the authorized purchase of that product, the right to be the exclusive reseller for that product is not automatically conveyed with the product purchase. Conceptually, the right to be an exclusive distributor of a product is more valuable than the right to be only a distributor; exclusivity rights provide greater business certainty in building brand value and customer awareness in the marketplace without concern that the efforts will instead benefit a competitor who is also a distributor of the same

products. In fact, in many instances the brand owner may also have developed intellectual property to further brand development and consumer demand creation, which also drive value and can be licensed along with the exclusive distribution rights. Executing on the concept, however, requires both a precise definition of the exclusivity right (and potentially of the brand awareness and demand creation rights as well) in isolation, and a way to accurately value those rights.

CJEU decision in 5th Avenue

5th Avenue Products Trading is a German wholesaler of, among other items, Cuban Havana cigars. 5th Avenue purchases these cigars from Habanos S.A. (Habanos). In 2012, 5th Avenue and Habanos entered into an exclusive distribution agreement (EDA), which gave 5th Avenue the exclusive rights for distributing Cuban Havana cigars in both Germany and Austria.

In exchange for the exclusive distribution right in Austria, 5th Avenue had to pay Habanos 25% of the sales revenue in Austria, for a period of four years. As agreed, after these four years, the payments stopped. No compensation was paid regarding the exclusive distribution rights in Germany. These facts and circumstances are illustrated in the graphic on the following page.



Batches of cigars were not ordered via a purchasing agreement, but rather in individual batch orders. 5th Avenue would receive a price list, on the basis of which it subsequently placed orders. After the placement of the order, Habanos would issue an invoice and deliver the cigars to 5th Avenue. The import of the cigars was handled through a type D customs warehouse in Germany, for which 5th Avenue had a license. The customs value that 5th Avenue declared consisted of the purchase price without taking the compensation payments into account. The reason for this was that, at the moment of the placement under the customs regime, it was not yet known in which country the cigars would be sold. During an inspection, the German customs authorities were of the opinion that the value of the compensation should be taken into account when determining the customs value of the cigars. In the appeals, the Finanzgericht Baden-Württemberg asked for a preliminary ruling and brought two questions before the CJEU about the customs valuation treatment of the compensation payments. In essence, the question is whether the compensation payments constitute royalties or license fees that are to be added to the customs value. The referring court assumes that that “compensation” enables 5th Avenue to sell the imported goods on the Austrian market for the very first time (distribution right) and covers the exclusive right to distribute the cigars in Austria (territorial protection).

Decision of the CJEU

On the basis of Article 29 of the Community Customs Code (CCC),¹ the customs value is the transaction value, being the price actually paid or payable for the goods on the moment of import, adjusted where necessary. According to Article 32(1)(c) of the CCC, royalties and license fees related to the goods being valued that the buyer must pay, as a condition of sale of the goods being valued, must be added to that price to the extent that those royalties and license fees have not been included in the price actually paid or payable yet. The CJEU noted, however, that, on the basis of Article 157(2) of the Implementing Regulation, the royalties and license fees relate solely to payments made by the buyer to the seller for the usage of intellectual property rights. Thus, the payments made in the main proceedings do not qualify as royalties or license fees.

To provide the referring court with all elements of interpretation of European Union (EU) law that may be of assistance, the CJEU restated the preliminary questions to be interpreted as whether the payments in question are to be added to the customs value. In this regard, the CJEU held that under Article 29(3)(a) of the CCC, the price actually paid or payable should include all payments made as “condition of sale” of the goods. Moreover, Article 32(5)(b) states that payments made in return for the right to distribute or resell the imported goods are not to be added to the customs value if they are not a condition of sale of the goods. According to the CJEU, a condition of sale should be interpreted as payments so important to the seller that without such payments, the sale would not have been concluded. From the information that is available, the CJEU concluded that the seller would not have supplied the goods for exclusive distribution in Austria without the payments, and thus that the payments in the main proceedings are a condition of sale. In this regard, it is irrelevant that the payments are imposed in the framework agreement of exclusive distribution rather than in each individual contract for the subsequent sale of the goods concerned. Furthermore, it is immaterial that the payments are only made for a limited period, being in this case four years.

¹ Council Regulation No. 2913/92 of 12 October 1992, establishing the Community Customs Code, OJ L 302, 19.10.1992, p. 1-50.

US authority

The CJEU decision is highly similar to a 2000 US Court of International Trade decision, *Tikal Distribution Corp. v. US*, 13 F. Supp. 2d 1269 (Ct. Int'l Trade 2000). In that case, the importer separately stated a fee for EDR on each import invoice, and the court effectively considered the fee to be part of the purchase price.

In 2013, however, US Customs and Border Protection (CBP) came to the opposite conclusion in a ruling for a global auto company, HQ H242894 (Dec. 4, 2013). The strategy behind the successful EDR ruling, and the ruling request, were developed by the EY team and designed to demonstrate that the EDR fee was paid for something other than products, was valued appropriately and was not paid as a condition of the sale of the product.

Background of US ruling

The US ruling was requested by the US subsidiary of a foreign auto producer. As part of the business plan to better enable brand and sales development, the parent company, which owns the brand rights, proposed entering into an EDR agreement with each of its distribution subsidiaries, including the US subsidiary, by which it will license the exclusive right to distribute branded vehicles and parts, as well as related intellectual property rights for building consumer brand awareness and creating product demand within a defined territory. In exchange for the EDR, each distributor will pay an EDR fee. The rights would be granted for a multiyear period, with the EDR fee determined at the beginning of the period and paid in instalments. The amount of each EDR fee is independently determined and supported by an EY study.

The US distributor will distribute vehicles that may be produced by the parent or by any of the subsidiaries, including vehicles that are produced in the US. Parts may be purchased from both related and unrelated supplies in a variety of countries. As is common in any CBP ruling, the ruling request included the distribution agreement, related contracts and sales documents, the EY study supporting the value of the fee, and an analysis of the EY team's views on the correct treatment of the fee.

CBP analysis

CBP analyzed the exclusivity fee to first determine whether it should be considered part of the price paid or payable, and if not, whether it should be considered an addition to the transaction value.²

US law is clear that all payments made by a buyer to a seller, or a party related to the seller, are presumed dutiable unless the presumption is rebutted.³ In the prior case involving exclusive distribution rights, *Tikal Distribution Corp.*, the importer was not able to overcome this presumption. In the instant case, however, CBP carefully reviewed the contractual terms, the method for determination of the fee and support for the amount of the fee to conclude that the importer had overcome the presumption of dutiability. CBP determined that the EDR fee is paid for separately defined and valued rights not related to the importation of vehicles and parts, and consequently cannot be considered an element of the price paid or payable for those vehicles or parts. CBP specifically noted that the mechanics of the calculation of the fee are not dependent on the volume of imports and are supported by external benchmarks compiled by the EY team. CBP also

commented that the licensor's remedy in the event of default for failing to pay the fee was termination of the exclusivity right, and not termination of the right to distribute, consistent with the importer's position that the exclusivity right had been effectively isolated.

CBP next reviewed whether the EDR fee is an addition to transaction value as a royalty or license fee. To be an addition to value, a royalty or license fee must be related to the imported product and paid as a condition of the sale of the product to the importer.⁴ Unlike the CJEU in *5th Avenue*, CBP did not foreclose the possibility that EDR could be considered intellectual property rights. Nevertheless, for reasons similar to those of the "price paid or payable" analysis, CBP concluded that payment of the fee is not a condition of sale of the imported product, and consequently is not an addition to value as a royalty or license fee.

Finally, CBP considered whether the EDR fee is an addition to value as a proceed of subsequent resale.⁵ While noting that the fee is paid to the manufacturer/seller, CBP determined that the fee was not derived from a subsequent sale of the imported product, and consequently is not an additional to value.

² US law follows the World Trade Organization (WTO) Valuation Agreement, and transaction value is the preferred method of customs valuation. Transaction value is defined in the US under 19 U.S.C. Section 1401(a)(b). The same definition is in Article 1 of the WTO Valuation Agreement, with additions to value discussed in Article 8.

³ *Generra Sportswear Co. v. US*, 905 F.2d 377 (Fed. Cir. 1990)

⁴ 19 U.S.C. Section 1401(a)(b)(1)(D); WTO Valuation Agreement, Article 8, paragraph 1(c)

⁵ 19 U.S.C. Section 1401(a)(b)(E); WTO Valuation Agreement, Article 8, paragraph 1(d).

Other global authority

There is little additional published authority on EDR. There is Canadian case law that excludes a fee paid to be an exclusive distributor from transaction value, but it deals with unrelated parties.⁶ A case in India also was decided in favor of the importer, although the rationale is not detailed, and the decision is currently on appeal.⁷ The EY team has had success in several other jurisdictions obtaining rulings stating that properly structured EDR fees are not dutiable, but those rulings are not published.

The World Trade Organization (WTO) Technical Committee on Customs Valuation (TCCV), which provides interpretation and guidance on the WTO Valuation Agreement is provided by the TCCV, considered a case study on EDR several years ago. After much discussion, and review of the US ruling, the TCCV concluded that the topic was too involved to be suitable for the type of guiding instruments it provides. The decision of the TCCV not to issue an instrument is further evidence of the need for detailed planning to execute on an EDR strategy.

⁶ *Simms Sigal & Co. Ltd. v. Commissioner of the Canada Customs and Revenue Agency*, Appeal NO. Ap-2001-016 (Canadian Int'l Trade Tribunal 2003).

⁷ *M/S Volkswagen Group Sales India PVT LTD v. Commissioner of Customs, Mumbai C/S/13671/12-Mum & Appeal No.C/524/12-Mum* (2013)

Other tax implications

While beyond the scope of this article, it is important to consider tax implications beyond customs when EDR are granted by a brand owner to a related party distributor. The separation of rights previously conveyed as part of product price has income tax transfer pricing implications. Consequently, the approach to valuing the rights and supporting documentation must be consistent with the transfer pricing approach of the business and the local country transfer pricing rules. It is also important to consider withholding tax implications. In instances where there is product manufacturing in multiple countries, it is not uncommon for brand rights to be conveyed by the brand owner to the manufacturer in the form of a manufacturing license, which allows the manufacturer to sell to a distributor with the embedded right to distribute the product. In these situations, the exclusivity right needs to be removed from the manufacturing license fee and replaced with the direct license of the exclusivity right to the distributor. This, in turn, changes the source of payment for intellectual property rights, which may be treated differently for withholding tax and may be subject to different withholding rates when subject to withholding. While this treatment needs to be carefully reviewed in each case, in some situations the business will also benefit from “rate arbitrage” in making this conversion.



Conclusion

The CJEU decision in 5th Avenue is a stark reminder that labels alone will not determine dutiability. Successfully executing an EDR strategy is complex, both technically and practically. The precise rights driving value need to be contractually defined in a

manner in which they can be practically conveyed and valued in isolation. Additional contractual provisions on sublicensing, product supply, and non-exclusively conveyed rights must be carefully drafted to support the concept. The transfer prices of both the intellectual property and the tangible property

need to be established and supported consistently with the business approach, transfer pricing methodology and customs analysis. Income tax consequences of the separation must be analyzed and can create separate reporting requirements.

When all of this is planned correctly, there is a strong argument to be made that a “condition of sale” does not exist. In the US, CBP has accepted this argument with the facts established in the US ruling. The US fact pattern, of course, has not been reviewed by the CJEU or in any published decision by an EU customs administration. It remains to be seen what might result from a well-planned EDR strategy in the EU as a result of the *5th Avenue* decision. ■



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How COVID-19 impacted supply chains and what comes next

Research shows severe disruption through the pandemic is driving enterprises to make their supply chains more resilient, collaborative and networked. Find the article on [ey.com](https://www.ey.com). ■

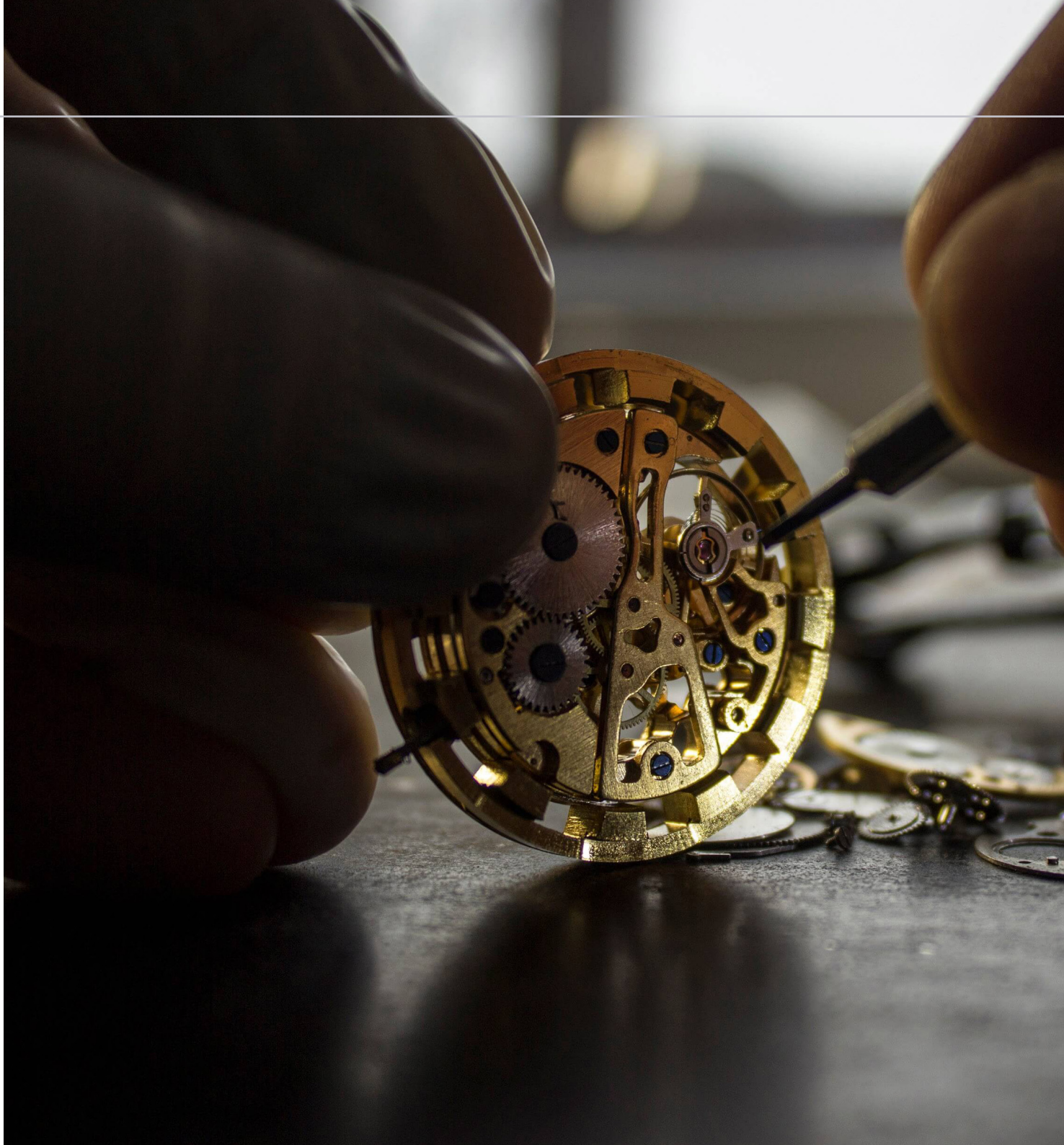


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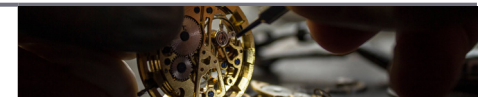
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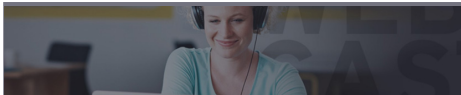
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Colombia: Green light for Authorized Economic Operator (AEO) authorizations



On 20 November 2020, the Colombian customs authority launched the fourth phase of implementation of the Authorized Economic Operator (AEO) program, allowing port facilities and port operators to access AEO authorization.

AEO is a global standard introduced by the World Customs Organisation (WCO) SAFE Framework of Standards to Secure and Facilitate Global Trade. AEO aims to enhance agile, transparent and secure foreign trade operations and contribute to trade facilitation, through strategic alliances between world's customs administrations and the private sector. According to the WCO's latest AEO Compendium,¹ globally there are 77 countries with operational AEO programs, 17 AEO programs to be launched, 31 operational customs compliance programs and two customs compliance programs to be launched. Countries that have implemented AEO programs include the United States (referred to by US Customs and Border Protection as the Customs-Trade Partnership Against Terrorism program), Mexico, Canada, Japan, Brazil, China, South Korea and Member States of the European Union.²

In Colombia, AEO authorization was formally established in 2011 and is currently available to exporters, importers, customs brokers, port facilities and port operators who, being part of the international supply chain, meet minimum security conditions and requirements to guarantee safe and reliable foreign trade operations.

Among the benefits that Colombian customs regulations offer to supply chain participants who meet the requirements for AEO authorization are:

- ▶ Recognition as a safe and reliable foreign trade operator
- ▶ Consolidation of import duties (customs duty and VAT) payment

¹ "AEO Compendium," *World Customs Organisation website*, accessed 6 January 2021. [Find it here](#)

² "AEO Programs in the World," *National Customs Directorate of Chile website*, accessed 6 January 2021. [Find it here](#)



- ▶ Reduction of recognitions and inspections
- ▶ Non-provision of insurance policies
- ▶ Recognition as AEO before customs administrations of other countries with which Colombia has signed mutual recognition agreements.³

To date, there are 231 authorized operators in Colombia, of which 31 are exporters, 102 are importers, 82 are both exporters and importers and 16 are customs brokers.⁴

Main requirements for authorization include:

- ▶ Registration in the Single Tax Registry with the type of user and activity on which the authorization is requested

- ▶ Experience of at least three years developing operations as an exporter, importer, customs broker, port facility or port operator, as applicable
- ▶ Favorable risk rating from the customs authority
- ▶ Demonstration of financial solvency in the last three years
- ▶ Corresponding authorizations issued by the control authorities

(Specifically, port facilities and port operators must provide documentation that support they have (i) port concession or operating permit granted by competent authority; (ii) authorization for the entry and exit of goods under customs control as a public or private dock port granted by the customs authority; (iii) compliance document issued by the General Maritime Directorate; and/ or (iv) resolution approving the regulation of technical operating conditions.)

- ▶ No sanctions affecting the security of the international supply chain

(In the case of port facilities and port operators, the applicant must not have been sanctioned by the Superintendency of Transport for noncompliance with security conditions during the last two years.)

Current regulations for port facilities and port operators establish 89 requirements that must be met and maintained by applicants. These are related to risk analysis and management, business partners,

safety of containers and other loading units, physical access controls, personnel security, shipping and receiving, physical security, information technology security, and security and threat awareness training.

With AEO expansion, the Colombian customs administration seeks to ensure the gradual participation of the different types of users that are involved in the international supply chain, thus minimizing the risk of illegal activities in foreign trade operations.

Additionally, from a business point of view, expanding the authorization also contributes to increasing its reliability and improving its relevance, making it the best option for companies looking to have secure and agile operations, since other customs figures have undergone frequent changes in recent years that have generated uncertainty and hesitation among foreign trade operators. ■

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1 Currently, Colombia has signed mutual recognition agreements with members of the Pacific Alliance, Andean Community and MERCOSUR, as well as with Costa Rica, Guatemala and Dominican Republic, to allow the recognition of AEOs between Customs.

2 "Authorized Economic Operator: Colombia," *Dian website*, accessed 6 January 2021. [Find it here](#)

Colombia: Recent changes regarding imports and exports

The Colombian Government is in the process of modernizing the current legislation for its import/export systems. In existence since 1967, the regulations were not only updated in general in 2020, but also different measures have been promoted to make the programs more flexible and promote exports.

Background

In August 2019, Colombia issued its new Customs Code.¹ With the new code, the Government aimed to modernize the complex regulation of import/export systems (commonly referred to as “Plan Vallejo Programs”). This modernization was established with the recent issuance of Decree 285 of 26 February 2020, and the provisions included in Resolutions No. 1054 and No. 1055 of 20 October 2020, and No. 1131 of 12 November 2020.

Import/export systems have their origin in the elimination of customs duties on imported goods for companies with export contracts signed with the Colombian Government. In 1967, Decree 444 established specific programs in which the import of certain goods (such as raw materials and supplies), and the subsequent export of finished products resulting from manufacturing or transformation from those materials, was agreed upon with the



Government to obtain certain benefits in the payment of customs duties and other taxes (deferral or no payment of customs duties and/or VAT).

These programs were adjusted and modified over time by different administrations, such as the creation of a procedure to grant exemptions in import duties (customs duties and VAT) on the imported supplies used in the production of exported goods.

Import/export systems programs

Import/export systems programs allow companies to import the following with total or partial exemption of import duties:

- ▶ Raw materials and supplies to be used in the transformation, elaboration or repair of goods that will be exported, totally or partially, within a specific period.
- ▶ Intermediate goods, capital goods and spare parts, if they are used in the production of goods that will be exported, or that are used for the provision of services directly linked to the production or export of said goods, or to the export of services.

The import operation under import/export systems programs is one kind of temporary import. Thus, the imported goods remain in restricted circulation. Each program has an export volume commitment that is verified and certified by the Colombian Ministry of Commerce.

¹ Decree 1165 of July 2, 2019, and Resolution 46 of July 26, 2019

Import-export systems: Definitions and benefits

1

Raw materials and supplies (art. 172 Decree 444)

Temporary import of raw materials and supplies, if they are used exclusively in the production of exportable goods.

Export commitment:
100% of raw materials and supplies

Benefit:
nonpayment of import taxes (customs duty and VAT)

2

Raw materials and Supplies (art. 173 (b) Decree 444)

Temporary import of raw materials and supplies destined entirely to the production of export goods, as long as the import of the final good is exempt of paying the customs duty (i.e., publishing sector).

Export commitment:
60% of raw materials and supplies

Benefit:
nonpayment of import taxes (customs duty and VAT)

3

Replacement program (art 179 Decree 444)

Those who export local goods produced using imported raw materials or supplies for which customs duties and taxes were paid, can import the same amount of those raw materials and supplies without paying import taxes (customs duty and VAT).

4

Capital goods and spare parts (art. 173 (c) Decree 444)

Temporary import of capital goods and spare parts to the installation of productive units that are used in the production of exportable goods, or to the provision of services directly related to the production or export of these goods.

Only for export goods included in the WTO Agreement on Agriculture

Export commitment:
70% of production increases

Benefit:
nonpayment of customs duty and deferred VAT

5

Capital goods and spare parts (art.174 Decree 444)

Temporary import of capital goods and spare parts to the installation of productive units that are used in the production of exportable goods, or to the provision of services directly related to the production or export of these goods.

Export commitment:
1.5 times the value of the imported goods

Benefit:
deferred VAT

6

Export of services

Temporary import of goods to be used in an export-of-services project.

Export commitment:
1.5 times the value of the imported goods

Benefit:
nonpayment of customs duty and deferred VAT

Key changes of the regulation issued during 2020

With the issuance of Decree 285 of 2020, the Colombian Government established general provisions for all import/export systems programs. The following details key provisions impacted by the changes:

- ▶ Users will not have to provide bank or insurance company guarantees to access the programs.
- ▶ The Ministry of Commerce has the authority to determine the lists of goods to be imported under the Programs of Capital Goods and Spare Parts and Export of Services.
- ▶ In the Export of Services Program, whoever presents an application to obtain said program may request the inclusion of new subheadings codes, as long as: (i) the goods to be included are directly related to the export-of-services project, (ii) they are depreciable tangible goods, and (iii) they have a useful life of more than 12 months.
- ▶ A sanctions regime is established, including a letter of reprimand by the Directorate of Foreign Trade of the Ministry of Commerce, the suspension of the program or the cancellation of the program.

Operationalizing the changes

The Colombian Government undertook these initiatives in response to seeking ways to increase Colombian exports through the different foreign trade instruments (free trade zones, international trading companies and import/export systems).

- ▶ Resolution No. 1055 of 2020 establishes rules for program users, defines procedural matters for submitting the application to any of the programs, and develops initiatives related to the verification

of export commitments and the modification of the programs (e.g., if the import quota is not fully used, for subheading code changes).

- ▶ Regarding capital goods that can be imported under the Capital Goods and Spare Parts Program, Resolution No. 1054 of 2020 indicates the list of subheading codes included in the program (included mainly in chapters 73, 84 and 90 of the Harmonized System Code, while for spare parts they are found mainly in chapters 39, 40, 73, 84, 85 and 90).
- ▶ For the Export of Services Program, Resolution No. 1131 of 2020 defines the list of subheading codes for the import of goods classified in the following activities: electricity supply, construction and engineering services, trade, land, sea and air transportation, auxiliary services in relation to all means of transportation, tourism and travel-related services, audiovisual, telecommunications, computing and related services, professional, research and development services, administrative and support services, education, health and social services, artistic, entertainment and other cultural activities, sports, recreational and leisure services.
- ▶ Finally, Decree 1371 of 19 October 2020 established transitory provisions for access in an express way to the import/export systems programs, to promote economic reactivation given the effects caused by the COVID-19 pandemic. With this decree, export commitments and the study period of the Ministry of Commerce to approve the request for any program are reduced. This provision will only be in force for 18 months from the date of its release.

Given the aforementioned benefits and special regime, companies in different sectors, such as personal care, textile, plastics and resin industries, tourism services, food industry and hotel facilities, among others, are submitting more Plan Vallejo requests before the Colombian Ministry of Commerce.

As import/export systems boost productivity and save resources from customs duty and VAT exemptions for enterprises, the Ministry of Commerce itself has committed with ease to administrative procedures, building trust and a strong interest from businesses with export capacity. Eligible businesses have benefited, and the modernization should both ease administrative requirements for those using it and enable new users. ■

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United States: Technical corrections to the USMCA Implementation Act – impact on free trade zones

On 22 December 2020, the US Congress included several technical corrections to the United States-Mexico-Canada Agreement (USMCA) implementing bill (19 USC 4531) within its broader omnibus legislation, which was presented to and signed into law on 27 December 2020, by former President Donald Trump as the Consolidated Appropriations Act, 2021 (PL 116-260).¹

Specifically, the legislation amended Section 202 of the USMCA Implementation Act to include a special US foreign trade zone (FTZ) origin rule. Under the act, which went into effect on 1 July 2020, and replaced the North American Free Trade Agreement (NAFTA), uncertainty existed for determining qualifying origin of goods specifically manufactured in an FTZ, although those goods would otherwise qualify as originating under the broader USMCA rules of origin.

The amended rule clarified that manufacturing in a US FTZ will not result in a good qualifying for preferential treatment under USMCA when withdrawn for domestic consumption. As discussed below, the amended rule also aligns with tariff treatment under NAFTA and other US free trade agreements (FTAs).

History

The NAFTA enabling legislation contained a specific provision, 19 USC 3332(a)(2)(A), which prohibited application of the NAFTA preference to goods made in an FTZ and entered for consumption (the origin restriction rule). Other US FTA enabling legislation does not have a similar restriction, although notes to the Harmonized Tariff Schedule of the United States (HTSUS) implementing those FTAs similarly prohibited applying FTA preferential origin from applying to goods made in an FTZ. As a result, the treatment of goods made in an FTZ was consistent in practice for all goods – an origin restriction rule applied regardless of whether a good made in an FTZ qualified for any FTA.

Early last year, on 29 January 2020, the USMCA implementing legislation was enacted and signed into law. As companies prepared for the USMCA's entry into force on 1 July 2020, FTZ manufacturers quickly noticed that the origin restriction rule present in NAFTA had not been included in the USMCA implementing legislation.

¹ [H.R.8337 – 116th Congress \(2019-2020\): Continuing Appropriations Act, 2021 and Other Extensions Act | Congress.gov | Library of Congress](#)





However, when the revised HTSUS was published on 2 July 2021, the USMCA rules allowed the USMCA “S” indicator to be used only on imports. By definition, import takes place at the time of arrival to the US territory. Imported items may be declared for entry into US Customs commerce at that point, or in the case of FTZs, may be admitted to the FTZ with entry occurring only if later the goods are removed from the FTZ for a US destination. In the case of manufacturing, imported materials or items are typically incorporated into new and different articles of commerce and are “entered” into US commerce from an FTZ upon withdrawal. Therefore, as with all other FTAs, this HTSUS note would prohibit goods manufactured in an FTZ from being entered using the specified preferential indicator, as they were not imported in the condition as entered.

Some FTZ manufacturers took the position that the omission of the statutory origin restriction rule in the USMCA enabling legislation evidenced a congressional intent to rescind the origin restriction rule, and that the HTSUS note on USMCA was in

error and should be changed. US Customs and Border Protection declined to issue direct guidance on this, instead seeking direction from the Office of the US Trade Representative or from Congress on intent in completing the USMCA or on USMCA implementing legislation.

Ultimately, it took nearly a year for Congress to provide clarification. Included in the USMCA technical corrections bill was the same origin restriction rule that had been in NAFTA:

“(3) SPECIAL RULE FOR FOREIGN-TRADE ZONES. Paragraph (1)(B) shall not apply to a good produced in a foreign-trade zone or subzone established pursuant to the Act of June 18, 1934 (commonly known as the ‘Foreign Trade Zones Act’) (19 4 U.S.C. 81a et seq.) that is entered for consumption in the customs territory of the United States.”

As a result, the status quo was maintained; an origin restriction rule applies to USMCA in the same way that it applied to NAFTA, and the HTSUS notes for all FTAs require a similar result.

Looking ahead

As trade disruption continues, this situation underscores the fact that companies understand how FTZ rules work within a variety of regulatory frameworks. The USMCA is not the only complex trade issue facing FTZ users. Consistent challenges around other topics, such as Section 321 (application of the de minimis rule), forced labor and withhold release orders, future FTAs and general FTZ treatment under punitive tariffs will be areas of focus for 2021.

Additionally, discussion surrounding the intent for USMCA origin restriction have brought more visibility to USMCA drawback and duty deferral program provisions, illustrating how US manufacturers may be disadvantaged compared to manufacturers in Mexico and Canada. With the new administration’s emphasis on supporting US manufacturing, the US FTZ program could play in role in expanding manufacturing and perhaps grow to provide additional manufacturing incentives in the future. ■

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Regional Comprehensive Economic Partnership (RCEP) – the transformative potential

Introduction

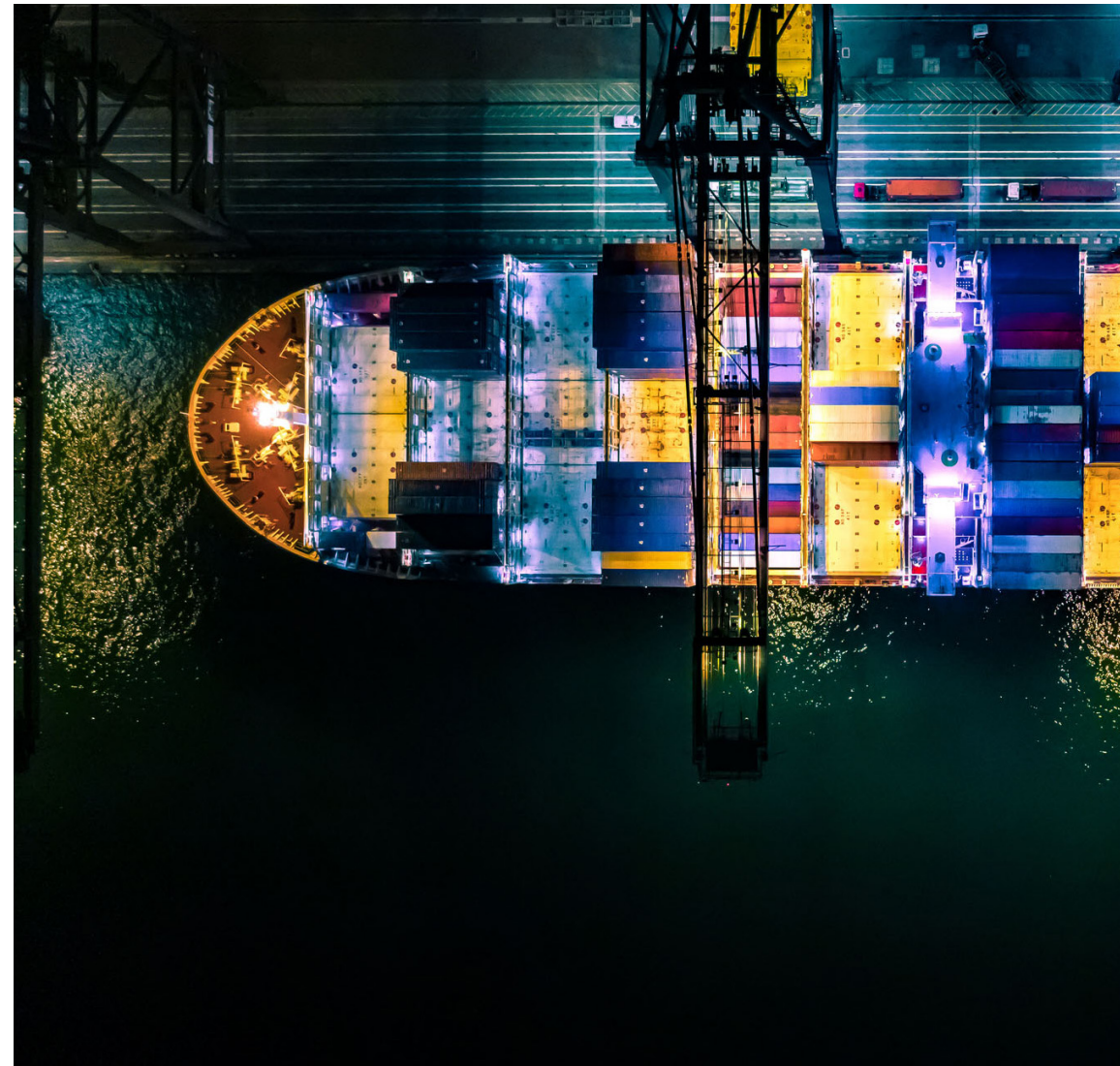
On 15 November 2020, 15 countries in Asia-Pacific signed the Regional Comprehensive Economic Partnership (RCEP) agreement. These countries include the Association of Southeast Asian Nations (ASEAN) member countries (i.e., Brunei, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) plus Australia, China, Japan, South Korea and New Zealand.

Originally proposed in 2011, RCEP negotiations were formally launched in 2012. Signing of the agreement came after more than 30 rounds of negotiations and after a number of ministerial meetings. During negotiations, India opted out due to concerns over tariff elimination, particularly as it related to trade from China and how this would impact its domestic industry. As RCEP is an open accession agreement, India can still opt to join, although there are no signs of this happening imminently.

The basics

Upon entering into force, RCEP will be the largest free trade agreement (FTA) in the world. The 15 member countries total approximately 30% of the world's GDP and 30% of the world's population. Member countries cover a wide range of GDP per capita, from low income to high income and, over the last 30 years, have been some of the fastest-growing economies in the world. RCEP is being promoted as an FTA that will support continuous high levels of growth, stimulating economies in a post-COVID-19 business environment.

It is expected to eliminate duties on 85% to 90% of tariff lines over a period of 20 years from the date of entry into force. This is not considered an aggressive target by comparison to other FTAs. For example, intra-ASEAN tariffs for ASEAN-origin products are at 0% for approximately 98% of tariff lines across the



10 ASEAN countries and at 0% for more than 99% of tariff lines across the six original ASEAN countries (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand).

Importantly, there will be a harmonized set of rules for determining country of origin, which will greatly simplify the various rules under existing FTAs in Asia-Pacific.

RCEP will enter into force 60 days after the date on which at least six ASEAN signatory countries and three non-ASEAN signatory countries have completed ratification. It is anticipated that a number of countries will ratify RCEP during 2021, with the agreement likely coming into force in 2022. Any countries yet to ratify RCEP will join thereafter upon completing due domestic process.

What's new?

There is already a significant network of FTAs within the Asia-Pacific region. The ASEAN group of countries has existing FTAs with China, South Korea, Japan, Australia and New Zealand. These FTAs are quite mature and already have removed many tariffs for products originating in member countries. For example, average tariffs under the ASEAN-China FTA are less than 1% for ASEAN-origin products exported to China, and vice versa. For products originating in ASEAN countries, additional tariff reductions under RCEP are therefore likely to be minimal, with many products only benefiting from RCEP after 10 years.

Importantly, this is the first significant FTA that connects China, Japan and South Korea – a key development. Even without an FTA between them, China and South Korea are Japan's largest and third largest trading partners, so the anticipation is that trade between these countries will gain particular momentum.

Whereas the Comprehensive and Progressive Agreement for Trans-Pacific Partnership looks to commit countries to open up their markets to services and also addresses some points around labor standards and the environment, RCEP does not capture a similar level of additional objectives and thus is considered somewhat modest in scope by comparison.

How can RCEP benefit companies?

As mentioned above, opportunities already abound under the current network of FTAs in Asia-Pacific. However, many companies do not avail themselves of the benefits. Despite the similarities between FTAs, there are also differences in the rules regarding how products can qualify for FTA benefits. As such, for many companies, the key challenge of utilizing FTAs is understanding the requirements that determine whether products qualify for preferential duty rates.

In this respect, FTAs are not “free” at all. Rather, they are conditional agreements that require company investment in both understanding the rules and developing processes and systems to facilitate compliance with the rules. The cost of

compliance can be considerable. This is why there is a perception, particularly in the Asia-Pacific region, that the major beneficiaries of FTAs have been large multinational corporations (i.e., companies with the resources to invest in exploring FTAs).

It is also true that the cost of compliance with FTA rules falls heavily on the exporter, with benefits accruing to the importer. If the exporter is somehow noncompliant, there can be significant commercial implications as the importer may be subject to recovery of underpaid duties and to penalties – which they will likely try to recover from the exporter. Many exporters, especially small and medium-sized enterprises (SMEs) that are selling to third parties overseas, would often rather forgo FTA benefits than be exposed to the commercial risk of noncompliance. However, this may result in the loss of potential customers due to the increasingly common requirement for buyers to insist upon Certificates of Origin to support reduced tariffs under FTA arrangements.

In addition to the obvious additional benefits of preferential tariffs under RCEP, limited though they may be to some companies, one of the most practical benefits of RCEP is the unified rules of origin. This is expected to considerably reduce the complexity and challenges of compliance, thus increasing the uptake of companies that avail themselves of FTA benefits. All companies will benefit from the RCEP unified rules of origin, but SMEs are likely to benefit the most. This benefit of RCEP should not be underestimated.



What are the origin criteria under RCEP?

The RCEP rules of origin set out the requirements for a good to be considered as originating in an RCEP member state. The originating rules also define what is considered as cumulation (the aggregation of qualifying content from multiple RCEP member states), minimal operations and processes, de minimis levels, direct consignment criteria and so on.

For a good to be considered an originating good, it must satisfy one of the following three basic requirements:

1. Wholly obtained or produced in a member country
2. Produced in a member country exclusively from originating materials from one or more of the member countries
3. Produced in a member country using non-originating materials, provided that the good satisfies product-specific rules (PSRs)

PSRs can include a change in tariff classification rule (i.e., change in chapter, change in tariff heading or change in tariff subheading), value-added rule (i.e., regional value content (RVC) of 40%) or chemical reaction rule, depending on the good.

For the value-added rule, the RVC is calculated by using either of the following formulas:

- a. Indirect or build-down formula: $RVC = (FOB - VNM) / FOB \times 100^1$
- b. Direct or build-up formula: $RVC = (VOM_{\text{direct}} \text{ labor cost} + \text{direct overhead cost} + \text{profit} + \text{other cost}) / FOB \times 100^2$

1 FOB means free on board, and VNM means value of non-originating materials.

2 VOM means value of originating materials

In effect, there are several alternate ways in which goods may qualify as originating, with the rules being, generally, relatively uncomplicated and for the large part are similar to existing rules of origin that we see in many ASEAN linked FTAs. Being unified within RCEP, providing alternatives to assert origin and being already familiar to companies that utilize the existing FTAs will aid the uptake of companies utilizing RCEP benefits.

Another significant benefit that RCEP has over the existing network of FTAs is that companies can work within a single cumulation arrangement covering all 15 countries. Companies that utilize RCEP will still need to match their materials procurement to make sure their manufactured goods qualify under RCEP origin rules. However, a company manufacturing in an RCEP member country and selling to any other RCEP member country will benefit from the scale and scope that RCEP's unified rule and 15 member countries offer. This will provide considerable opportunities to companies in the area of raw material procurement.

For all that the unified rules will do to help companies, RCEP member countries have also sought to make sure that FTA benefits are within the scope they wish to offer. They have therefore introduced a "tariff differentials" anti-circumvention measure. This is for specific items listed by each importing country in their annex to tariff reduction schedule. For such listed products, additional origin requirements are provided to determine the RCEP originating countries. Companies should review these details on a product and country basis.

Conclusion

RCEP has arrived at a good time. There has been considerable trade disruption in the last few years, and COVID-19 has damaged many economies. RCEP serves as a statement from the 15 member countries to indicate that they support international trade and are looking to create an FTA for Asia-Pacific that will drive growth over the next few decades.

When comparing the benefits available under existing FTAs as well as the broader scope of more recently concluded FTAs, observers argue that the current RCEP agreement is limited in scope and not ambitious. However, the ASEAN countries in particular have a history of agreeing to an FTA and then accelerating benefits or building upon it with enhancements. In that respect, RCEP can evolve and, over time, could become the comprehensive FTA that the business community seeks. In the meantime, there are immediate FTA benefits for some trade flows, as well as the unification of origin rules across 15 countries that should increase uptake in realizing benefits.

Companies should examine the potential for RCEP benefits that may accrue from within their existing manufacturing footprint. With the tariff reduction schedules already known, this can be an immediate activity, albeit there will be a delay for ratification and for RCEP to come into force.

Certainly, companies that are making any strategic decision on their manufacturing footprint, such as around the investment in a new or expanded facility, must consider RCEP as a key factor. The likelihood of a new round of multilateral tariff reductions under the auspices of the World Trade Organization is quite slim. As such, FTAs are clearly the route to reduce cross-border tariffs, with RCEP over time becoming the primary, or dominant, FTA for companies in Asia-Pacific. ■

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Japan: Annual report on post-entry audits

Japan's Ministry of Finance released a report regarding post-entry customs audits that were conducted between July 2019 to June 2020. This report can be very useful for the importing community as it highlights both the focus areas of Japan Customs' audits and common compliance errors. In particular, the cases highlighted in the report demonstrate often-overlooked compliance obligations and, where appropriate, how they can be addressed proactively.

In this latest report, Japan Customs found that customs value was underdeclared by more than JPY120 billion, which is an approximate 20% decrease in value compared to the previous year. However, this decrease may be in part explained by the decline in the number of audited importers (approximately 85% of the previous fiscal year).

In total, Japan Customs assessed a total of JPY11.6 billion in underpaid duties/taxes and administrative penalties, which includes JPY55.4 million in penalties for fraud or gross negligence. The top five imports with the largest underpayment of customs duty and import consumption tax are listed by Harmonized System (HS) chapter in the table opposite.

| Imports (HS chapter) | Duty/tax shortfall (in JPY billions) |
|---|--------------------------------------|
| Electrical equipment (Chapter 85) | 2.3 |
| Optical instruments and apparatus (Chapter 90) | 1.9 |
| Machinery and mechanical appliances (Chapter 84) | 1.5 |
| Tobacco and manufactured tobacco substitutes (Chapter 24) | 0.6 |
| Plastics and articles thereof (Chapter 39) | 0.5 |

Together, these five chapters account for about 60% of the total underpaid duties/taxes. Three of the top five imports have been on the list for the last two years – electrical equipment (Chapter 85), optical instruments and apparatus (Chapter 90), and machinery and mechanical appliances (Chapter 84). The underpaid duties/taxes are JPY2.2 billion, JPY1.9 billion and JPY1.4 billion, respectively. In particular, electrical equipment (Chapter 85) and optical instruments and apparatus (Chapter 90) have



been repeatedly listed in the top five, while neither tobacco and manufactured tobacco substitutes (Chapter 24) nor plastics and articles thereof (Chapter 39) has been in the top five for the past several years.

Major examples of customs violations

The report published by the Ministry of Finance also highlighted some specific cases where importers were subjected to additional duties. These cases concern two types of violation – (1) cases that do not involve fraud or gross negligence and (2) cases that do involve fraud or gross negligence.

Cases not involving fraud or gross negligence

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

► Case 1: Failure to report dutiable development costs

An importer of telecommunications equipment from Taiwan had been paying development costs in respect of the imported products as agreed with the exporter. These payments for development costs were separate from the invoice price for the imported goods. However, the importer failed to declare these payments as part of the customs value. Due to this oversight, the importer was found to have underdeclared by a total of JPY 889.5 million and was assessed a total of JPY78.2 million in underpaid taxes and administrative penalties.

► Case 2: Declaration of tentative price, without post-importation adjustments

An importer of pharmaceutical products from Ireland declared imports based on a tentative invoice price provided by the exporter. There were subsequently additional payments made for the difference between the tentative price and final price. Whereas such payments should have been included in the customs value, the importer failed to file amended declarations to reflect this change in the import value. As a result, the importer was found to have underdeclared by a total of JPY3.9 billion and was assessed a total of JPY344.5 million in underpaid taxes and administrative penalties.

Cases involving fraud or gross negligence

In cases involving fraud or gross negligence, importers are required to pay penalties for fraud or gross negligence, which is generally imposed at 35% to 40% of the underpaid duties/taxes.

► Case 3: Declaration of falsified invoice created by exporter

An importer of clothing from China instructed the exporter to create invoices with lower prices for declaration purposes. The importer declared these lower prices as the customs value. As a result, the importer was found to have underdeclared by a total of JPY109.6 million and was assessed a total of JPY27.6 million in underpaid taxes and administrative penalties, of which JPY6.9 million was the penalty for fraud or gross negligence.

► Case 4: Declaration of falsified invoice created by importer

An importer of plastic pellets and other goods from China created invoices with lower prices for declaration purposes and declared these as the customs value, despite being aware of the proper prices of the imported goods. This resulted in a total of JPY51.1 million in underdeclared customs value and a total of JPY8.5 million assessed underpaid taxes and administrative penalties, of which JPY2.1 million was the penalty for fraud or gross negligence.

Implications for importers

The cases highlighted above reinforce the continued focus by Japan Customs on the declared import value and the fact that companies must focus on correctly declaring the customs value in accordance with the Japanese Customs Tariff Law.

It is important to note that the failure to declare payment made separately from invoice price as part of the customs value has been reported continuously in the past years. In Case 1 above, the importer should have included the development costs in the declared customs value, while in Case 2, the importer should have filed an amended declaration to reflect the additional payment made on the initially declared tentative price. In addition to these cases, the Ministry of Finance has reported that cases in which the importers failed to report the costs of materials provided by the importers to the exporters are quite prevalent when such materials were provided free of charge.



As illustrated in the cases on the previous page, it is crucial that importers understand the Japanese Customs Tariff Law, and declare appropriate customs values or file amended declarations in accordance with this law. Often, companies simply overlook the need to make post-importation adjustments to previously declared import value.

Importers into Japan should be aware that Japan Customs continues to rigorously and regularly enforce compliance, and any noncompliance uncovered is penalized. As such, maintaining appropriate internal compliance mechanisms and processes to facilitate compliance with import and export legislation should be a top priority for companies. ■

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Malaysia: Enhancements to the Authorized Economic Operator (AEO) program

Given Malaysia's trade-to-GDP ratio of over 130%, international trade is one of the country's key drivers of economic growth. It has diversified from an economy focused on agriculture and commodity-based industry to one that exports products such as electrical appliances, parts and components.

The speed and security of cross-border movements of goods, together with efficient and reliable customs procedures, are of vital importance to support the manufacturing and trading sectors of Malaysia. However, the significant increase in global cross-border trading volumes and the vulnerability of global trade to internal and external threats could damage and disrupt supply chains, both domestic and cross-border.

In view of this, Malaysia previously adopted the World Customs Organization (WCO) Standards to Secure and Facilitate Global Trade (also known as SAFE) framework and further introduced the AEO program on 1 January 2010. The majority of the AEO program participants are manufacturers, exporters and importers who are involved in cross-border movements of goods.

The AEO program in Malaysia provides AEO-certified operators with the following benefits¹:

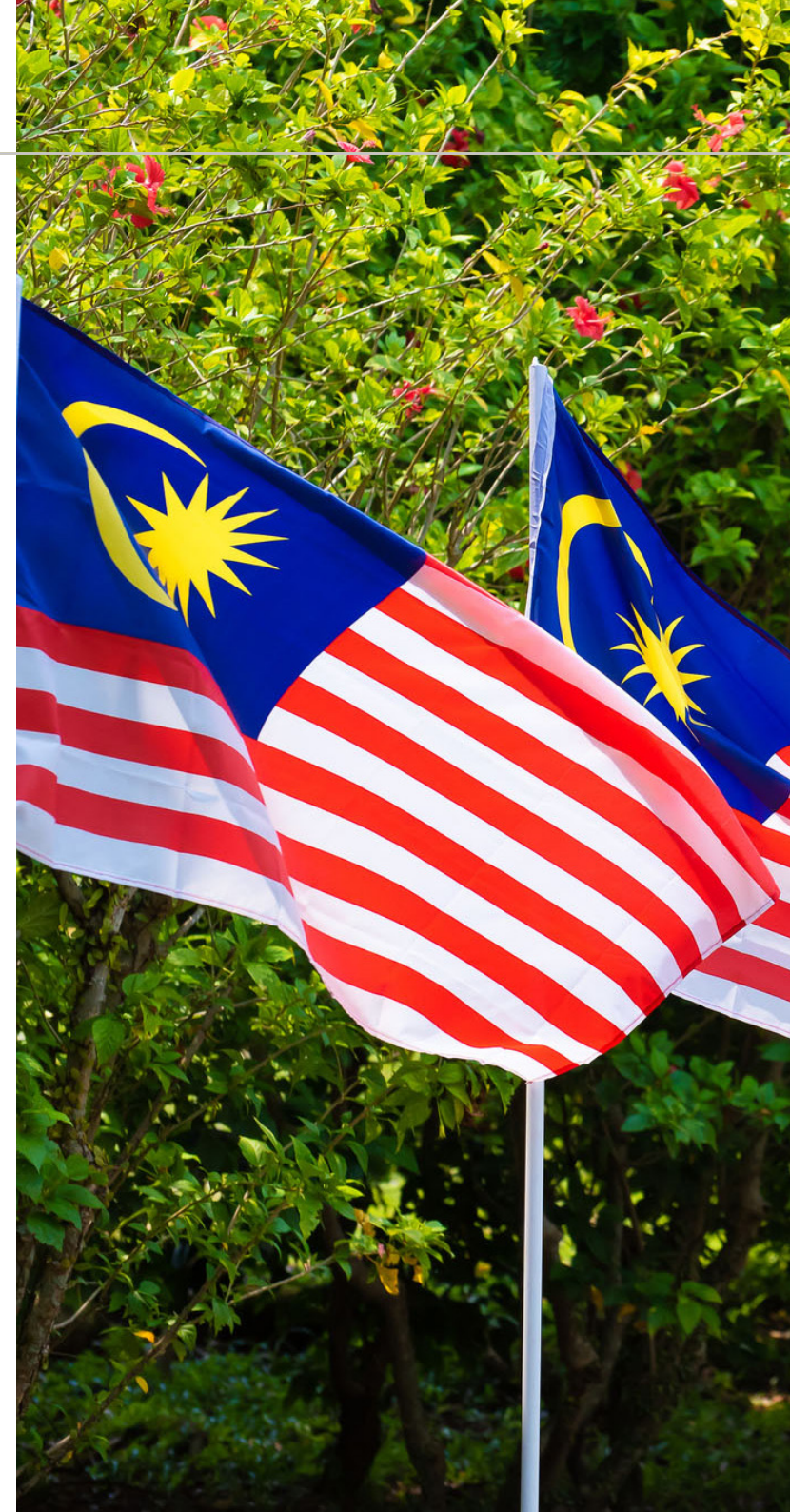
1. Automated and fast approval (self-declaration)
2. Fast clearance (e.g., improving lead time on export from 28 hours to 1 hour)
3. Control by post-clearance audit
4. Simplified drawback claim
5. Deferred payment of duties and taxes
6. Licensed Manufacturing Warehouse (LMW) operators certified as AEOs not required to submit the monthly filing requirement for the Movement of Raw Materials (M1) and Statement of Finished Products (M2)

In addition to the above benefits of being an AEO-certified operator, the country's Minister of Finance recently announced in the Budget 2021² speech on 6 November 2020, that the Malaysian Government will introduce enhancements to the AEO program:

- ▶ The AEO program will be implemented at the national level with the aim of facilitating the AEO accreditation process

¹ "Compendium of Authorized Economic Operator Programmes", WCO website, accessed 8 February 2021. [Find it here](#)

² "Budget 2021 speech," Ministry of Finance Malaysia website, accessed 8 February 2021. [Find it here](#)





- ▶ The AEO designation will be expanded to include logistic service providers (LSPs) and approved warehouse operators (WOs)
- ▶ Forty-three permits and trade license issuing agencies will be integrated into the AEO platform.

To date, the Royal Malaysian Customs Department (Customs) has certified 146 Malaysian AEOs.³ Although the AEO program in Malaysia is already a decade old, so far there has been little take up by Malaysian businesses. Only after the Budget 2021 announcement did the AEO program begin gaining traction in Malaysia.

Impact for industry players under the recently added categories for the AEO program

With the inclusion of LSPs and WOs as eligible applicants for the AEO program, these two categories of industry players have a new advantage, especially given the speed and efficiency in trade.

LSPs and WOs who are AEO-accredited would be able to minimize the downtime caused by time-consuming and complex customs declaration processes, thereby expediting the delivery and removal of goods.

As key players in both domestic and global supply chains, LSPs and WOs are expected to face the greatest challenges from port congestion when the economy begins to recover from the current downturn related to the COVID-19 pandemic. AEO-certified LSPs and WOs would benefit from their status as preferred traders, with a faster and more predictable flow of trade.

³ Number of certified AEO as informed and presented during a Customs webinar conducted in November 2020.

Implementation of the AEO program at the national level, and the addition of 43 permits and trade license issuing agencies, is an indication of the Malaysian Government's intention to boost awareness and streamline the AEO accreditation process. With expansion of the AEO program only recently announced, industries are not fully aware of such incentives.

Summary

We can expect additional guidelines and benefits to be introduced as Customs works alongside the newly integrated trade license issuing agencies to facilitate trading across borders.

The appeal of the AEO program to the existing categories of businesses will continue to grow in Malaysia, especially with more mutual recognition agreement (MRA) activity between countries whereby the MRA would enable companies to be recognized in MRA signatory countries.

The AEO program will be an increasingly important tool for Malaysian manufacturers to support the expansion of their cross-border activities. Considering these recent enhancements, Malaysian importers and exporters should evaluate the prospects of obtaining an AEO accreditation. ■

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Vietnam: Free trade agreements – opportunities and recommendations

Starting in 1986, Vietnam focused on a range of reform policies (also known as Doi Moi, which means renovation) that sought to support trade liberalization and free-market-oriented measures. These policies have resulted in fundamental changes to the economic development of the country, bringing a vibrant economy in Vietnam and one of the most successful in Asia.

One of the most important reform policies was related to export and import activities. Vietnam strongly encouraged exports as well as gradually opening its domestic market to foreign goods, while also allowing foreign companies to set up subsidiaries in Vietnam to engage in a wide array of business activities, including trading and manufacturing. As part of this reform, Vietnam integrated widely and deeply into an international network of free trade agreements (FTAs), beginning with the Association of Southeast Asian Nations (ASEAN) Free Trade Area in 1995 and continuing in subsequent years with other countries and territories.

By early 2021, Vietnam had signed 15 FTAs, of which 13 had taken effect. These FTAs have brought significant opportunities for both exports from Vietnam as well as imports from those free trade agreement (FTA) signatories. In addition, the FTAs have enhanced the level and volume of trade between members and deepened Vietnam's connections to overseas markets.

Fully utilizing the benefits of these FTAs can help businesses reduce their customs duty costs, making their products more competitive in a growing number of markets.

Customs duty benefits for imported goods into Vietnam

As of 2020, the number of tariff lines entitled to an FTA rate of 0% ranged between 29% and 98%, depending on the specific FTA, as shown in the below table.¹ By their respective year of completion, these FTAs will have 72% to 100% of tariff lines entitled to an FTA rate of 0%:

| | FTA | Year of effect | Year of completion ² | Percentage of 0% duty lines by year of completion | Percentage of 0% duty lines by 2020 |
|----|---|-------------------|---------------------------------|---|-------------------------------------|
| 1 | ASEAN | 1999 | 2018 | 98.00% | 98.00% |
| 2 | ASEAN-China Free Trade Area (ACFTA) | 2005 | 2020 | 90.00% | 86.00% |
| 3 | ASEAN-South Korea | 2007 | 2021 | 87.00% | 86.00% |
| 4 | ASEAN-Australia-New Zealand | 2009 | 2022 | 90.00% | 87.00% |
| 5 | ASEAN-India | 2010 | 2024 | 74.00% | 56.00% |
| 6 | ASEAN-Japan | 2008 | 2025 | 87.00% | 60.00% |
| 7 | Vietnam-Japan | 2009 | 2026 | 90.00% | 74.00% |
| 8 | Vietnam-Chile | 2014 | 2029 | 89.00% | 31.07% |
| 9 | Vietnam-South Korea | 2015 | 2029 | 89.70% | 83.80% |
| 10 | Vietnam-the Eurasian Economic Union and its Member States | 2016 | 2027 | 87.10% | 74.01% |
| 11 | ASEAN-Hong Kong, China | 2019 | 2032 | 72.00% | 29.00% |
| 12 | Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) | 14 Jan 2019 | 2034 | 98.02% | 45.50% |
| 13 | European Union-Vietnam Free Trade Agreement (EVFTA) | 1 Aug 2020 | 2035 | 100.00% | Not applicable |
| 14 | Regional Comprehensive Economic Partnership | Not yet effective | | | |
| 15 | Vietnam-United Kingdom | Not yet effective | | | |

¹ Source: Vietnam's General Department of Customs as at November 2020.

² Year of completion: the last year of the staging period an FTA for duty elimination/reduction.



Using Harmonized System (HS) code 73151910 as an example, the import duty rate for this type of product into Vietnam under the most-favored nation (MFN) and selected FTAs would be as follows:

| Products and HS code | Import duty in Vietnam | | | |
|---|------------------------|--------------------------------|-------|------------------|
| | MFN | ASEAN Trade in Goods Agreement | EVFTA | ACFTA |
| Part of bicycle or motorcycle chain (HS code: 73151910) | 35% | 0% | 25% | 50% ¹ |

With this information, Vietnamese importers can significantly reduce their import duty rate based on where they source their products.

Customs duty benefits for exported goods from Vietnam

This also means that goods originating from Vietnam can be eligible for preferential duty rates when sold overseas to FTA member countries or territories, thus promoting Vietnam exports.

In general, under relevant FTAs, the duty reduction commitments of Vietnam’s FTA partners for Vietnamese goods are higher than those of Vietnam imported goods. For FTAs to which ASEAN is a signatory (commonly referred to as ASEAN+ FTAs), the rate of free trade liberalization for Australia and New Zealand covers 100% of tariff lines, with China and South Korea at 92% to 94%, Japan at 84.5% and India at 74.3%. For some relatively new FTAs, this rate is even higher – the number of 0% tariff lines will reach 99% under the CPTPP and 100% under the EVFTA and the ASEAN-Hong Kong, China Free Trade Agreement.

¹ Defaults to the lower MFN rate
² Source: ASEAN Secretariat; Vietnam’s General Department of Customs: EY analysis.

Customs duty benefits for goods stored in “bonded zones” or “non-tariff areas” in Vietnam

Although some aspects of Vietnam’s domestic regulations for implementation of FTAs remain unclear, in principle, it should be possible to obtain non-manipulation certificates and back-to-back Certificates of Origin for those goods originating from other FTA countries that are routed through a distribution hub in Vietnam. Of course, this is on the condition that the goods meet the necessary rules of origin of the relevant FTAs. This will help businesses retain the origin of goods so that they can enjoy preferential duty rates when the goods are re-exported into other FTA countries or territories, or even imported into domestic Vietnam.

With increasing self-certification of origin, uncertainty about how to retain FTA benefits when utilizing a distribution hub in Vietnam has decreased.

As such, Vietnam is increasingly viewed as a potential distribution hub location by multinational companies, and we are seeing a growing number of companies include Vietnam on their short list as they review and change their international supply chains. This is particularly the case as companies have been responding to trade disruption between China and the US, often moving manufacturing into Vietnam. It should also be noted that infrastructure and logistics capabilities in Vietnam are quickly improving, especially with the effectiveness of the EVFTA, which strongly encourages and generates more favorable conditions for foreign investment in the logistics services industry.

Other benefits

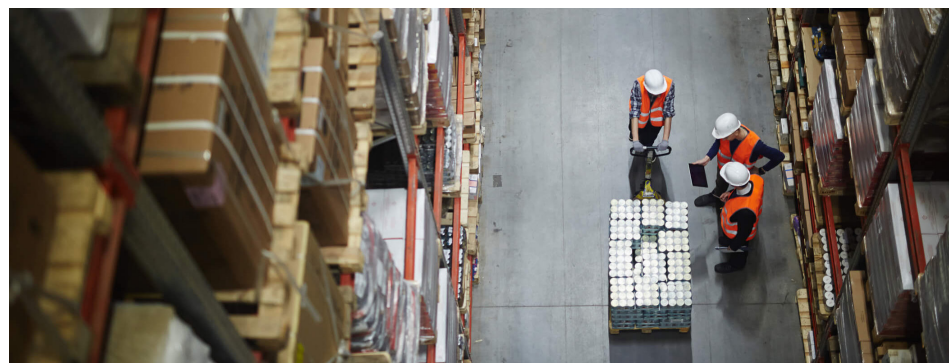
While duty reduction is a core benefit of most FTAs, they can also provide other important benefits such as eligibility to conduct trade in services, removal of regulatory and technical barriers for particular goods, access to bidding for public procurement, measures on intellectual property protection and so on. These added benefits vary widely across different FTAs, and companies need to review relevant FTAs to identify potential benefits for their business beyond preferential duty rates.

Summary and recommendations

FTAs are increasingly a feature of trade with Vietnam. Due to changes in supply chains as a result of global trade tensions, many companies have established an increased presence in Vietnam, either with their own manufacturing facilities or as a source location for procurement.

While taking advantages of these FTAs, businesses should carefully evaluate compliance requirements as the penalty for not doing so can be considerable. Even minor errors may result in penalties.

Vietnam’s increased network of FTAs and more supportive trade facilitation environment are promoting companies to consider it as a distribution hub location, particularly for Southeast Asia. Until recently, this would not have been the case, but the picture is rapidly changing. A detailed and structured approach to drive FTA benefits in Vietnam is necessary, but the potential for a return on this investment is greater than at any time in the past. ■



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Africa: How free trade can accelerate Africa's COVID-19 recovery

The African Continental Free Trade Agreement has the potential to accelerate Africa's COVID-19 recovery and reshape the continent. Read the article on ey.com ■

Brexit: Update on EU-UK trade relations

On 31 December 2020 at 23:00 GMT, the transition period ended, and the EU-UK Trade and Cooperation Agreement (EU-UK TCA) came into force. The EU-UK TCA is a free trade agreement (FTA) between the United Kingdom (UK) and the European Union (EU) that now governs trade between the two parties.

What is covered by the EU-UK TCA?

Zero tariffs: The deal provides for tariff-free, quota-free access for products traded between the UK and EU. However, this is accompanied by a number of new customs procedures and formalities, including new “rules of origin” requirements, which are needed in order for products to qualify for the tariff-free, quota-free treatment.

Technical barriers to trade: Specific annexes were agreed upon to reduce the non-tariff barriers for medical, automotive, chemical and organic products, and wine.

Government procurement: Despite expectations to the contrary, the UK and EU agreed to continue to allow access for their respective businesses to bid for each other’s government procurement contracts, going beyond the obligations set out in the World Trade Organization (WTO) Government Procurement Agreement.

Road haulage: Haulers can continue to operate between the UK and EU, and to transit through UK or EU territory. UK haulers also will not need European Conference of Ministers of Transport permits.

Air transport: Air transport of passengers and cargo can continue without quantitative restrictions on capacity or frequency (although UK airlines will no longer be able to fly between two points in the EU, so-called “onward legs”). With regard to aviation safety, both sides will recognize the validity of each other’s safety certificates and licenses.



EU programs: The UK has continuing access to various EU programs, including Horizon Europe, the Euratom Research and Training Programme, the ITER fusion test facility, the Copernicus observation program and the EU’s Space Surveillance and Tracking services. However, the Erasmus student program is not included.

UK-Turkey: Finalizing the EU-UK TCA has enabled the UK to reach a continuity trade agreement with Turkey, which will be extremely beneficial for many supply chains that rely on the EU-Turkey Customs Union to source products. The UK and Turkey have committed to expanding this agreement in the future to include services trade and investment.

What is not covered by the EU-UK TCA?

Services trade: While services provisions have been included, they do not go much beyond existing EU practice, and notable barriers limit the scope of many services providers to trade between the EU and the UK. Barriers include the end of the mutual recognition of professional qualifications, and significant carve-outs from the EU regarding the extent to which it commits to allowing UK service providers to access their EU customers.

Conformity assessments: There is no agreement on the mutual recognition of conformity assessments, which means UK manufacturers need to have their products assessed for compliance with an EU-notified body, and vice versa.

Agri-food: The two sides have not agreed on how to reduce the burdens of sanitary and phytosanitary checks and cooperation, which require enhanced regulation and physical checks for products of human, animal and plant origin. There was also no agreement on geographical indications beyond what was already set out in the Withdrawal Agreement.

Trade remedies: Trade remedies are policy tools that allow governments to take remedial action against imports which cause injury to domestic industry. The EU-UK TCA includes virtually no restraints to prevent the UK and EU from using trade remedies against each other. This means that the much-fought-over “level playing field” provisions in the agreement may have less power than expected, because either side can revert to trade remedy action as an alternative resort.

What happens next?

While the agreement entered into force at the end of the transition period, it is in provisional application at the time of writing, which means that it still needs to be formally ratified by the European Parliament. The original deadline for this ratification was in February 2021, but a deadline extension to 30 April 2021 has been agreed to enable adequate scrutiny by the EU's parliament before full ratification. Once European Parliament approval is received, the agreement still needs to be finally adopted by EU Member States via a note of consent to the European Council before it is fully ratified. The UK, in contrast, has already fully ratified the agreement.

Although the agreement is fully in force, and this is expected to remain the case, the current state of play will not remain completely static for the foreseeable future. There are a number of upcoming operational changes, as well as some phased changes set out by the agreement.

For example, the agreement includes staged transitional rules of origin for electric vehicles and their batteries. Meanwhile, from a border formality perspective, the UK is implementing phased border formalities for goods entering Great Britain (GB) from the EU, as set out in the Border Operating Model document.



These changes coming into force over time mean that businesses need to make sure they understand not just their requirements in the short term, but also future requirements that will impact them in the coming months and years.

Seven ways to support effective trade in goods under the EU-UK TCA

While the impact of the EU-UK TCA is significant, we have produced a list of seven actions that businesses can take now to help ensure their trade in goods under the EU-UK TCA is supported. These actions are as follows:

1. Understand key trade flows between the UK and the EU

A view of the key trade flows into and out of the UK and EU is needed to support other recommended preparation steps. This can include an understanding of the key flows of goods, as well as how other stakeholders are involved in these movements of goods. Relevant stakeholders include customers, suppliers and service providers such as customs brokers.

2. **Ensure that products are accurately classified**

Accurate tariff classification of goods being traded has four key roles. Firstly, accurate tariff classification of products must be included on customs declarations as a compliance obligation. Secondly, it enables the business to understand its potential duty exposure, as customs duty rates are set out on a commodity-by-commodity basis. Thirdly, tariff classification mandates what product-specific rules of origin apply to a product. Last, it also determines whether additional documentary compliance requirements are in place for the movement of goods.

3. **Check the duty rates on your products in the relevant tariff**

Using the tariff classifications on goods, potential duty exposure on trade flows can be understood. The duty rates for each product are set out in the trade tariff of the different administrations. For UK imports, these are set out in the UK Global Tariff. For EU imports, the duty rates are set out in the EU Common Customs Tariff.

4. **Where duty is due on imports, determine whether products meet the rules of origin to qualify for duty-free treatment**

If a positive rate of duty will be charged on movements of goods, then the EU-UK TCA may mitigate this, provided that the goods are deemed originating. For this reason, the business should review the product-specific rules of origin to evaluate whether its products are deemed originating and thus eligible to claim preferential rates of duty on trade between the UK and the EU.

5. **Research whether specific documentation is required for imported or exported products (e.g., animal health certificates)**

For some goods, additional documentation must be provided to meet compliance obligations, and if it is not provided, the goods will be added to the EU's Prohibitions and Restrictions List (P&R List). Often, these documentary or process requirements, prohibitions and restrictions relate to commodity codes as set out in the relevant trade tariff. In addition, the EU's P&R List and Annex C of the UK Government's Border Operating Model can be used to help identify products impacted by additional or specific requirements.

6. **Put processes in place to provide documentation as required to move goods or receive duty-free treatment**

To reduce the potential for disruption or excess cost, businesses should have processes in place to provide or obtain documentation as required, which could be for the purposes of importing/exporting goods, meeting product-specific compliance requirements or receiving preferential treatment. Often, this documentation needs to travel with the goods, but in some cases digital formalities are required.

7. **Make sure that customers, suppliers, and brokers know their roles and responsibilities**

In an international supply chain, there is typically reliance upon external stakeholders for various facets of movements. For example, reliance may be placed upon a supplier to provide documentation to prove the originating status of goods, or under some Incoterms a customer may be required to be the importer of record and therefore complete import formalities themselves. Ensuring that other businesses in the supply chain are also ready to trade under the new arrangements can help to reduce the risk of disruption, as well as facilitate actions such as claiming preference to make use of duty rate reductions under the EU-UK TCA. ■

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Brexit: The impact on EU businesses

On the evening of Christmas Eve 2020, Ursula von der Leyen, president of the European Commission, announced that the European Union (EU) reached a trade deal with the United Kingdom (UK). One of the main features of the EU-UK Trade and Cooperation Agreement (EU-UK TCA) is that it provides for zero quotas and zero tariffs. Although leaders from both the EU and UK advertise that free EU-UK trade is guaranteed with this trade deal, businesses face increased administrative burdens while trading goods between the EU and UK as of 1 January 2021. This contribution explains why that is and discusses also the opportunities/challenges under the EU-UK TCA.

Border controls

The UK left the EU on 31 January 2020. As the EU and UK arranged for a transitional period until 31 December 2020, during the remainder of 2020, EU-UK trade flows were not subject to any border controls. This changed on 1 January 2021. As of that date, EU-UK trade flows are subject to full EU border controls. Where the UK decided to provide for a three-staged introduction of applied border controls, the EU did not foresee any grace period or staged introduction of border controls. That means that, despite the existence of the EU-UK TCA, EU customs authorities enforce the same border



controls on UK goods as for goods coming from third countries without a trade agreement with the EU in place.

The border controls include the requirement that a full customs declaration be submitted at entry of the goods into the EU customs territory, and additional import requirements and checks may be applicable; for example, some goods are subject to sanitary or phytosanitary controls (e.g., animal and plant products). To complete the customs declarations commodity codes, customs values, EORI numbers and, in some cases, a customs representative are required, all of which must be taken into account and give rise to an increasing administrative burden on traders.

EU-UK TCA and the impact on the rules of origin

Highlights

The EU-UK TCA entered provisionally into force on 1 January 2021. The EU-UK TCA does not remove the need for companies to make changes to their operations. However, it does bring some certainty on many of the new trading rules that are being applied as of 1 January 2021, most notably tariffs. There will be tariff-free, quota-free access for products traded between the EU and UK under the EU-UK TCA if the goods originate in the EU or the UK. However, this involves several new customs procedures and formalities, including new rules-of-origin requirements in order to qualify for the tariff-free, quota-free treatment. As another highlight, specific annexes were agreed upon to reduce the non-tariff barriers for medical products, automotive, chemical products, organic products and wine.

It is important to stress that claiming preferential treatment under the EU-UK TCA is not obligatory. For goods that are unconditionally free of import duties, there is no need to claim tariff-free, quota-free access under the EU-UK TCA or to comply with the rules of origin requirements. If goods are subject to import duties, businesses could choose to make use of preferential treatment under the EU-UK TCA, but then they should comply with the rules of origin, which are explained in more detail below.

Rules of origin

The Free Trade Agreement (FTA) provides for zero tariffs and zero quotas on all goods, but only insofar as the goods comply with the appropriate rules of origin. For products to qualify for the EU-

UK TCA, there are both general origin rules and product-specific origin rules based on a product's tariff classification. These rules are broadly comparable with other EU and UK FTAs. While tariff classifications vary, for most classifications there are two options for meeting the product-specific origin rules: (1) a difference in the tariff classification of the finished product and its non-originating materials at the heading or subheading level (first four- or six-digit tariff code change); or (2) a maximum

percentage value of non-originating materials (MaxNOM) in the finished product, most commonly 50%. Accurate tariff classification will therefore be critical for businesses, whether to determine the product-specific rule of origin or to assess whether the product qualifies with that rule of origin.

With MaxNOM, the cumulation rules allow both EU and UK originating materials and production costs to be treated as qualifying FTA content in the relevant calculation (i.e., bilateral cumulation). The agreement does not, however, permit cumulation with other countries with which both the EU and UK have separate bilateral FTAs (i.e., no diagonal cumulation). This will not impact the UK FTAs that do permit EU content to be diagonally cumulated (e.g., the UK-Switzerland trade agreement).

Proof of origin

To claim preferential treatment under the EU-UK TCA, proof of origin must be available. Proof of origin under the EU-UK TCA can take the form of a statement of origin or a claim for preferential treatment in light of the importer's knowledge that the product is originating.

The statement of origin shall be made out by an exporter of a product on the basis of information demonstrating that the product is originating by using one of the language versions set out in the EU-UK TCA in an invoice or on any other document that describes the originating product in sufficient detail to enable the identification of that product. It is important to stress that the rules on issuing the statement on origin differ depending on whether it concerns an EU-UK or UK-EU trade flow:

1. For EU-UK flows: Statement on origin can be made out by any exporter where the value of the consignment is EUR6,000 (approximately £5,700) or less. Above this amount, the EU exporter must have a Registered Exporter (REX) number and include it in the statement.
2. For UK-EU flows: The GB EORI number of the exporter should be included in any statement it issues to the EU customer, regardless of the value.

If no statement on origin is being provided, the importer could claim preferential treatment based on its knowledge that the product is originating. That information can, for example, be obtained by the importer from the exporter, manufacturer or producer of the product. The information available to the importer should be in the form of supporting documents that demonstrate that the product is originating and should satisfy the requirements established in the EU-UK TCA. Information provided could include the HS code of the product and origin criteria used, a brief description of the production process and information about product-specific origin rules based on a product's tariff classification.

Challenges

As the EU-UK TCA was only published a week before the date of entry into force, businesses likely have not had the opportunity to adapt to the new rules. One challenge is related to issuing a statement of origin as an EU exporter. This can only be done if the exporter applied for a REX registration. In case a REX registration was not yet available to the exporter, preferential treatment could be based on the importer's knowledge. Typically, however,



the importer does not have sufficient information at his or her possession to prove that the products are originating, unless the importer is related to the exporter or, in case of a “delivered duty paid” or consignment delivery, is also acting as exporter. Alternatively, if the importer did not make a claim for preferential tariff treatment at the time of importation, it can also do so within three years after the date of importation.

Another challenge that has hit EU businesses particularly hard is the limited scope of application of the returned products scheme provided for in Article 15 of the EU-UK TCA. Under certain conditions, this scheme allows for an originating product to be sent to a third country, and upon return it shall still be considered an originating product. “Third country” in the context of this provision does not include the EU or UK. This means that if EU originating goods are shipped to the UK, preferential treatment can be claimed, but upon return of the same goods in the EU, tariffs will be imposed. This also applies the other way around, where UK originating goods are sent to the EU and then, without alteration, are returned to the UK. This is even the case if the goods are stored in a customs warehouse in the other territory. Unlike with the Comprehensive Economic and Trade Agreement, there are no provisions or guidance to also apply the returned products scheme in this type of situation. EU businesses that use the UK as a distribution hub or transit country for deliveries from one EU Member State to another are hit especially hard.

Opportunities

The EU-UK TCA provides for several opportunities, with the most important one being the tariff-free, quota-free access for originating products traded between the EU and the UK. It is essential that, depending on the type of proof of origin, the exporter or importer has sufficient information showing that the products are originating. A supplier’s declaration can in that case be needed, especially if the exporter or importer is not the producer or manufacturer of the product. A supplier’s declaration is a declaration whereby a supplier provides information to its customer (either the importer or exporter) concerning the originating status of goods with regard to the specific preferential rule of origin. The EU provides for a grace period with regard to issuing supplier’s declarations. An EU exporter is allowed to make out a statement on the basis of information already at his or her disposal even if he or she receives the formal supplier’s declarations only afterward. The exporter is still responsible, however, for ensuring that the statement on origin and the information provided is correct. The exporter must also have all the relevant supplier’s declaration by 1 January 2022, at the latest, or else inform the importer that the statement of origin cannot be substantiated.

Another advantage is that this trade deal does not restrict combining the use of inward processing (IP) with claiming preference under the FTA. IP is the relief of customs duty and import VAT on raw materials and components when the finished product is exported. Under most EU agreements, only IP or the FTA may be claimed on a particular trade flow

– not both. There is a clause stating that this may be reviewed after two years, but this is a positive outcome for businesses seeking to mitigate their end-to-end duty costs.

Despite the limited scope of the returned goods scheme for EU-UK trade flows, there will be no customs duty in either direction when goods are moved between the EU and the UK for repair. This avoids the need for traders to operate IP or outward processing to manage duty costs. It does not address the VAT treatment in such flows, so that should continue to be a consideration, especially when the importer is not the owner of the goods.

Finally, another opportunity for businesses is the EU-UK TCA’s provision for mutual recognition and comparable treatment for traders with Authorised Economic Operator (AEO) Safety and Security (AEO (S)) or that element of AEO (F)) status in either the EU or UK. This does not, however, extend to AEO Customs status (AEO (C)). ■

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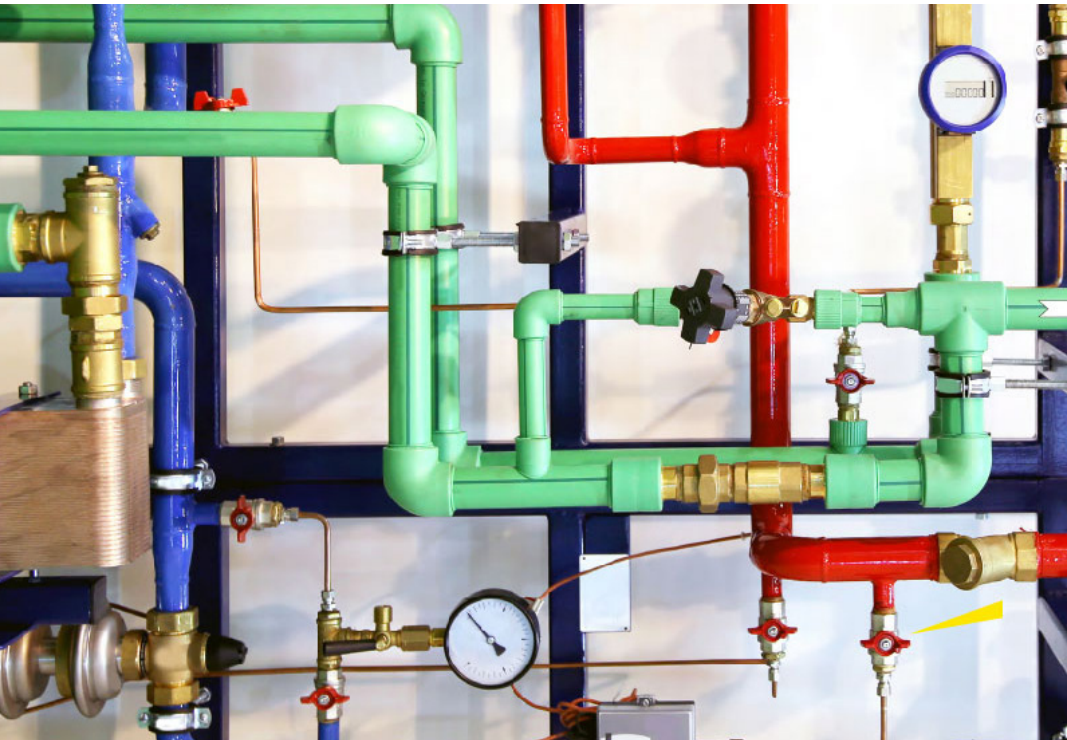
Brexit: What rules of origin requirements mean for UK-EU trade

Under a free trade agreement, preferential duty rates or tariff-free trade depend on a good's national source.

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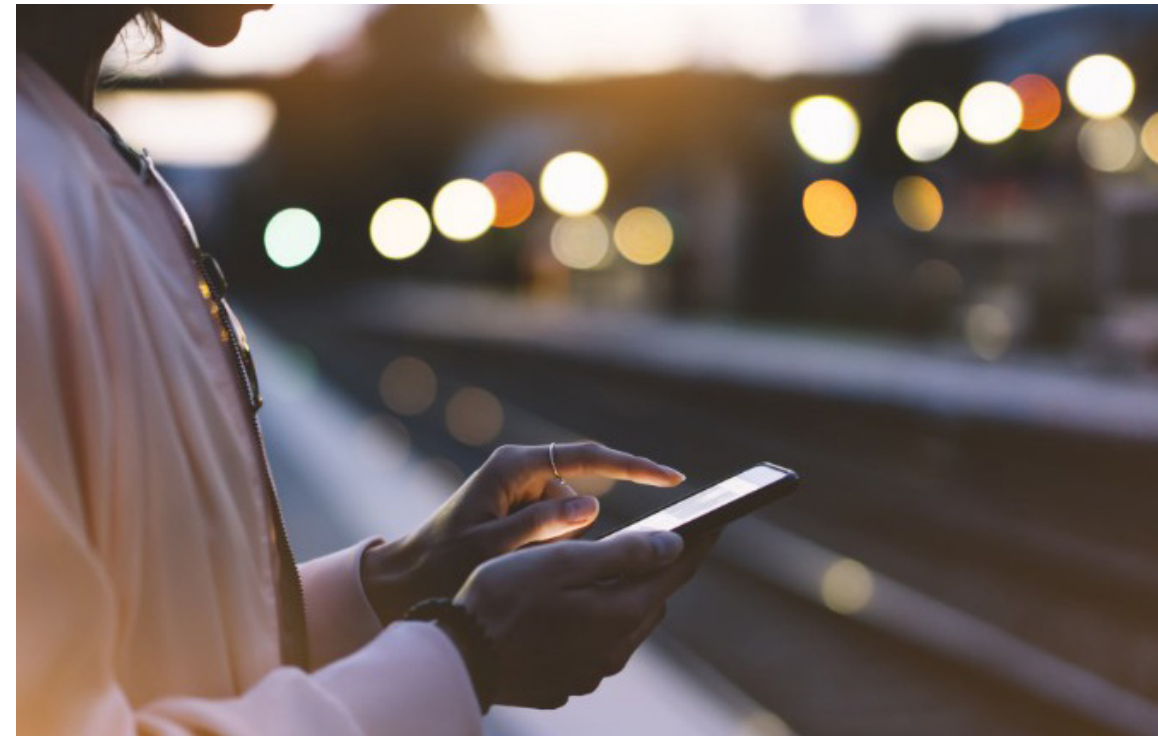
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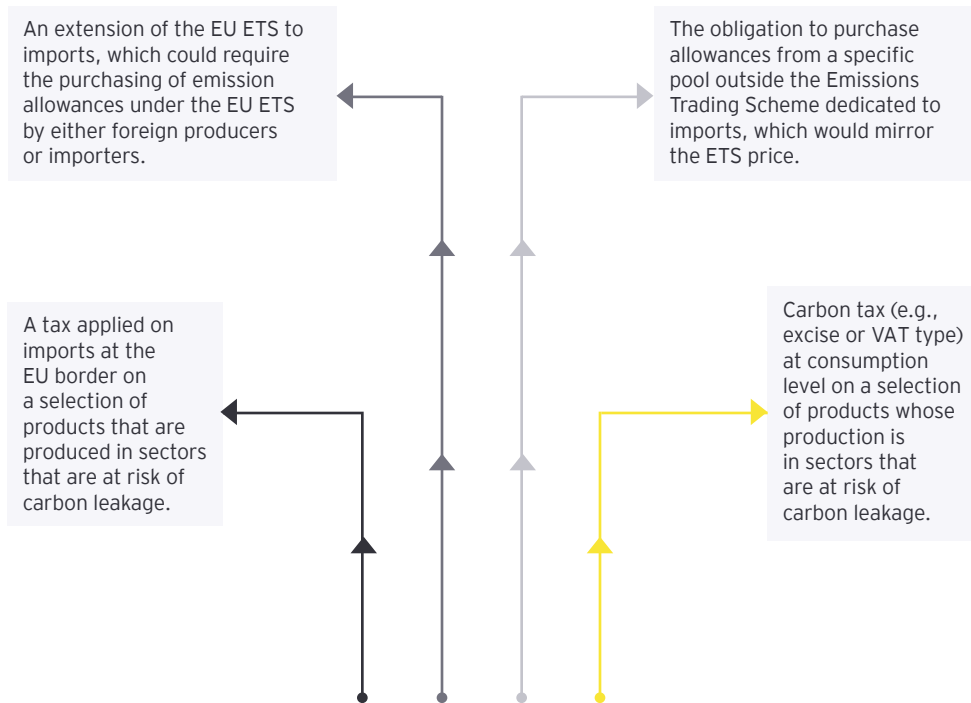
EU: Proposals for carbon border adjustment mechanism

To counteract carbon emissions, countries across the world take measures to reduce these emissions. The European Union (EU) has ambitious policy goals in this respect. As part of the European Green Deal, the EU aims to become the world's first climate-neutral continent by 2050. The carbon border adjustment mechanism (CBAM) was brought forward as a tool to support these high policy ambitions. The CBAM is now even higher on the agenda of the EU as a result of the EU Recovery Plan published by the EU in July 2020 in response to the COVID-19 pandemic. The plan aims to recover the EU from the economic downturn caused by the COVID-19 pandemic and simultaneously build a greener, more digital and more resilient Europe. The introduction of various new own resources is being proposed to reach those goals. These new own resources all take the form of an indirect tax. The own resources proposed are a plastic levy, a CBAM, digital services taxes, an extension of the EU Emission Trading System (EU ETS) and (potentially) a financial transaction tax. The aim is that the CBAM enters into force in 2023.

Between 22 July and 28 October 2020, a public consultation took place, and as a result, the European Commission plans to table a proposal for a carbon border adjustment mechanism for selected sectors in 2021. This CBAM should serve as an instrument to avoid carbon leakage, by taxing imported goods based on their carbon content. By taking into account the carbon intensity of goods sold into the European Union, a level playing field should be established. Since the CBAM proposal has not been released, the design of the CBAM is not yet clear. In that regard, there are various options that could be considered, four of which are displayed in the graphic below. The option chosen must be feasible from a legal as well as a technical perspective. That means for example, that the rules are compatible with World Trade Organization rules and European law, meaning no

discrimination and based on objective criteria. Together with other stakeholders, EY is involved in assisting the European Commission with the design of this mechanism.

Possible design options



For companies, it is crucial to start preparing for the introduction of the CBAM by developing a comprehensive CBAM strategy. The below graphic shows which actions could already be taken by businesses in the coming year.



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EU: Is VAT deduction on imported goods dependent on ownership?

The Court of Justice of the European Union (CJEU) has ruled again that an importer who does not dispose of the goods as owner in situations where the import costs are not incorporated in the prices of specific output transactions or goods and services supplied by the importer in the course of its economic activities, does not have the right to deduct VAT.

Weindel case (C-621/19)

On 8 October 2020, the CJEU decided on the case between the Financial Directorate of the Slovak Republic and Slovak company Weindel Logistik Service SR spol. s.r.o. (Weindel), concerning the interpretation of Articles 167 and 168(e) of the European Union (EU) VAT Directive in connection with the appellant's right to deduct VAT assessed on imported goods.

Background

Weindel, a company established and registered for VAT purposes in Slovakia, imported goods from Switzerland, Hong Kong and mainland China for the purposes of repackaging them in the territory of Slovakia. As the stated consignee and declarant on the import customs declaration, Weindel released the goods into free circulation and simultaneously became liable to pay Slovak import VAT. After the goods were repackaged, they were exported to a third country, and the repackaging services were invoiced to the customer. The foreign customer retained ownership of the goods throughout this time.

Since the postponed import VAT accounting is not applicable in Slovakia, Weindel paid the VAT from the imported goods to the customs authority and claimed the right to deduct import VAT. The tax authority denied the VAT deduction on the grounds of noncompliance with domestic legislation, specifically due to the



fact that Weindel was not the owner of the goods and did not assume the right to dispose of the goods as owner. The cost of the goods was thus not directly and immediately linked with its economic activity because Weindel had neither sold them in its national territory, nor supplied them to an EU or third country. Consequently, the case was referred to the CJEU.

Decision

According to the CJEU Order, Article 168(e) of the EU VAT Directive must be interpreted as precluding the right to deduct VAT for an importer who does not dispose of the goods as owner and where there are either no input import costs, or they are not incorporated in the prices of specific output transactions or goods and services supplied by the taxable person in the course of their economic activities.

It is important to note that this decision was issued in the form of an Order— a measure the CJEU typically employs when it believes that its response to a referral is sufficiently unambiguous and can be clearly deduced from existing case law.

DSV Road case (C-187/14)

Indeed, this matter has already been the subject of CJEU jurisprudence in the past. One judgment that in particular should be considered with regard to VAT deduction on imported goods is the judgment of 25 June 2015 (reference number C-187/14), in the case of DSV Road A/S (DSV Road), a Danish transport and logistics operator.

Background

DSV Road initiated, as the principal, external transit procedures for transport of goods from Denmark to Sweden. However, the consignee in Sweden refused to accept these goods. Thus, the goods were transported back to Denmark, without the transit documents having been canceled and without the goods having been presented to the customs authorities. At the same time, DSV Road was neither the importer nor the owner of the imported goods.

These same goods were later dispatched again for a second time, together with other goods, as part of another external transit. This time, the transit procedures were correctly discharged but the Danish Ministry of Taxation disputed whether the goods covered by the first transit procedures were also included in the second transit procedures. On that basis, DSV Road had to pay the resulting customs duties and VAT on the import of the goods that were subject to those procedures. However, even though DSV Road paid the VAT on the import, its right to deduct that VAT was refused.

Decision

The CJEU concluded then that the provisions of the EU VAT Directive do not contradict national law, which does not give the right to deduct this tax in a situation where the entity paying the import VAT is a carrier performing only customs clearance and transport of goods (and is neither the importer nor the owner of the goods in question).





The *DSV Road* ruling also noted, like in the *Weindel Logistik* case, that the goods imported can be considered to be used for the purposes of the taxed transactions of a taxable person under the condition that the value of the imported goods must be a cost affecting the value of the taxable sale.

Why is this relevant?

Following the judgment in the *DSV Road* case, the local tax authority in the EU began to take an unfavorable position against importers who import goods owned by another entity. Poland is one of the countries where the change in the tax authorities' approach to import VAT deduction was clearly visible after *DSV Road*.

Based on the Polish VAT Act, the taxpayer for the import of goods is the entity that is obliged to pay the customs duty – even if, based on relevant customs regulations, there is effectively no customs duty to be paid (e.g., due to duty suspension or a preferential zero rate) and regardless of how the input VAT is settled (i.e., paid to the customs office and later deducted or only reported in the VAT return). To be eligible to deduct the VAT, the taxpayer should have the appropriate customs clearance documentation, which is why special care should be taken to ensure that accurate data is provided for the imported goods and the parties involved. In turn, according to Article 77 (3) of the Union Customs Code, the declarant – i.e., the importer – shall be the debtor. In the event of indirect representation, the person on whose behalf the customs declaration is made shall also be a debtor. At the same time, under Article 168(e) of

the EU VAT Directive (incorporated also in the Polish VAT Act), the right to deduct import VAT is granted to the taxpayer who uses the imported goods for taxable activities.

Similarly, in Slovakia, the standard practice of the Slovak tax authorities prior to the *Weindel* decision was to grant the right to deduct VAT only to a taxable person designated as importer or recipient of the goods in the import customs declaration. This is further conditional on whether the importer holds title to the goods at the moment of import and their use for taxable transactions. This has caused issues in practice; for example, situations when the recipient of the goods did not take title or became owner of the goods later, after they had been imported (e.g., consignment stock or financial leasing situations).

While the *DSV Road* case considered customs debt (and import VAT) incurred through noncompliance with customs procedures, the *Weindel* case confirms that the issue with VAT deduction is not limited only to such scenarios. In practice, there may be various transactions, carried out in compliance with customs regulations, in which the owner of the imported goods will not be the VAT taxpayer for the import transaction. This will be the case when that entity is not the declarant for customs purposes. For example, this may occur when the importer is a local entity performing services on entrusted goods (owned by a foreign entity), such as processing or packaging, as was the case in the *Weindel* case.

If the import of goods involves any of the following, the importer may not be entitled to deduct VAT on the import of such goods.:

- ▶ The importer is not the owner of the goods
- ▶ The importer does not acquire the right to dispose of the goods as the owner
- ▶ The import costs are not incorporated in the prices of particular output transactions or the goods or services supplied in the course of importer's economic activities (and they are not directly and immediately related to the overall economic activity of the importer)

It will then be non-deductible for both the importer (declarant) and the owner of those goods, who under the Polish VAT Act is not a taxpayer for import. Following the CJEU order in the *Weindel* case, it will likely become even more

difficult to recover import VAT. The practice indicated by the court may have a significant impact especially for both service recipients and local service providers offering services on imported entrusted goods carried out in the European Union, e.g., in toll manufacturing setups.

Even after the CJEU's *Weindel* Order, this approach may raise some doubts as to who should bear the costs of the import VAT. Some issues that are not yet resolved include the following:

- ▶ Should import VAT deduction be limited for entities not owning the imported goods, if import VAT itself may be due on the movement of goods into the customs territory of the EU, regardless of whether this movement is performed in connection with a sale or transfer of the right to dispose of these goods as the owner?
- ▶ Should the cost of VAT be borne by the importer if they are not the final consumer but only act as a service provider?
- ▶ Does the condition that the value of the imported goods must be a cost affecting the value of the taxable sale mean that it should only increase the value? Or could it also be argued that the value of the imported goods affects the value of the taxable sale by lowering it? For example, if a local toll manufacturer imports goods provided free of charge for processing, could it be argued that the value of the subsequent taxable sale (covering service and material costs) is lower than it would be in an alternative (hypothetical) scenario, where the toll manufacturer would have to acquire these materials themselves? Otherwise, adding the costs of the imported goods provided free of charge to the toll manufacturer to the value of their service would be illogical, as then the service recipient (being the owner of these goods) would effectively have to bear the costs of these goods twice.
- ▶ Should it not be sufficient that the imported goods are used in the performance of taxable activities? Even though *Weindel* would be unable to perform taxable sales (packaging services) without the imported goods, the CJEU Order seems to prove that this is not enough to have the right to deduct (the link between payment of import VAT and the price of services provided by *Weindel* was insufficient).

Actions for businesses

To avoid bearing import costs of VAT under similar structures, when a taxable person renders work on goods without owning them, it will be necessary to explore the possibility of redesigning the transactions. In this situation, foreign entities purchasing services in EU countries may want to consider:

- ▶ Importing goods on their own, which will be subject to additional customs and tax formalities
- ▶ Applying a special customs procedure (e.g., inward processing or customs warehousing, (both of which will most often require the involvement of third parties – service providers from a given EU country of import, such as a customs/tax representative or an entity authorized to operate a bonded warehouse) and/or obtaining appropriate registrations or permits by a foreign entrepreneur in Poland

On the other hand, it appears that the CJEU's Order may serve as good news for recipients of goods in countries like Slovakia who seek deduction of import VAT but cannot prove ownership at the moment of import (e.g., consignees buying goods on DDP Incoterms). In such a case, the right to deduct import VAT should be justifiable if the costs of the import are incorporated in the price of the person's taxable output transactions. Since the Slovak tax authorities have not yet issued their position on the *Weindel* decision or any official guidance as an implementation of this case, we look forward to seeing whether their approach – and that of authorities in other EU countries – to VAT deduction in similar situations will change in the future. ■

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Norway: VAT and customs issues with supply and install contracts



Introduction

Contracts under which foreign suppliers of goods export goods to Norway for installation may yield unexpected consequences from a VAT point of view. Many foreign companies have been assessed for not charging VAT on these supplies. In addition, the tax administration has questioned whether Norwegian customers are entitled to deduct the import VAT when they have acted as the importer of record for the installed goods.

During the last few years, the Norwegian tax authorities have focused on these types of contracts due to the numerous incorrect VAT treatments applied to such projects. If these supplies are not handled correctly, there is a high risk of assessment, interest and penalties not only for the supplier but also potentially for the customer.

The Norwegian VAT rules related to the supply of goods and services

In principle, VAT is payable when goods or services are supplied domestically in Norway.¹ Businesses and public enterprises must be VAT-registered once their turnover exceeds NOK50,000 (approximately EUR4,800) during a 12-month period.

Services related to physical work carried out in Norway – for example, the installation or assembly of goods or real property – are deemed to be domestic sales in Norway and are subject to Norwegian VAT.

Normally, when goods are sold by a foreign supplier for exportation from the supplier's country for sale to Norway, the business must clarify on a

¹ Norwegian VAT Act, section 3-1.

case-by-case basis whether the sale is deemed to be a domestic sale in Norway. If it is not treated as a domestic sale, the supplier is not responsible for charging Norwegian VAT. However, based on the practice of the tax administration and on case law,² if the supplier's sales activity is deemed to be specifically targeted to the Norwegian market the sale is deemed to be a domestic sale in Norway, triggering a VAT obligation for the supplier.

The following factors are examples indicating that the sale of goods from abroad would be deemed to be made domestically in Norway from a VAT perspective:

- ▶ The seller has a place of business, assets or staff in Norway
- ▶ Transfer of risk (legal place of delivery) takes place in Norway
- ▶ Customer contact takes place in Norway
- ▶ Marketing activities exclusively target the Norwegian market
- ▶ The company's website is on a Norwegian domain
- ▶ The website content is tailored to the Norwegian market
- ▶ Customers are unaware that they are buying goods from a seller outside of Norway

Regardless of whether the export sale is deemed to be a domestic sale, import VAT is payable upon importation to Norway. If the importer of record

is VAT-registered in Norway, import VAT shall not be reported and paid to the Customs. Instead, the import VAT will be reported in the VAT return. If the goods are to be used in the VAT-registered business of the importer, the import VAT may be deducted as input VAT.

Supplies of goods for installation in Norway

Foreign companies and Norwegian customers often enter into contracts that state the seller shall supply goods/equipment for installation in Norway. These contracts are common, for example, for so-called "turnkey projects", where the goods are legally delivered to the customer (risk is transferred) when the installation in Norway has been completed. In such cases, the arrangement with the customer is often as follows: the foreign seller ships the goods to Norway, where the Norwegian customer acts as the importer of record. Since the importer is responsible for the import VAT, the seller assumes that the sales of goods are deemed to be export sales in its country that do not require the seller to register for VAT or to charge VAT in Norway. In many cases, the seller does not register for the supply of goods or for the installation services.

In situations like this, where a foreign supplier enters into a single contract both for the supply of goods and installation in Norway, so-called "supply and install" contracts, the tax authority's position is that the entire delivery, both the goods and the installation service, is deemed to be a domestic sale in Norway for VAT purposes. As a consequence, the supplier must register for VAT in Norway and charge Norwegian VAT on the full contract value.

Further, since the goods are subject to installation work in Norway before the project is finished, there is also a risk that the tax office would argue that the customer is not entitled to deduct the import VAT when acting as the importer of record.

In these cases, the tax authorities do not follow the normal procedure when goods are sold for exportation to Norway (i.e., they do not consider on a case-by-case basis whether the seller has adjusted its sales activity to specifically target the Norwegian market). So that even if the supplier has not done this, it can have a responsibility to register for Norwegian VAT.

The terms "installation" and "assembly" are not defined or explained in the legislation or in any published guidelines. Based on our experience, even very limited elements of installation/assembly may trigger the VAT treatment as a supply and install contract. Therefore, even if the duration of the installation work is very brief, the number of employees sent to the site is few and the value of the installation work compared with the value of the goods is limited, there is a clear risk that the tax office will argue that the agreement constitutes a supply and install contract from a VAT perspective.

It is important to note that a supplier's VAT obligations are not impacted by whether it uses a Norwegian subcontractor to perform the installation in Norway or conducts these services with its own employees who travel to Norway.

² Rt-2006-364.



Consequences of incorrect VAT treatment

Based on the practice of the tax administration, a supplier conducting supply and install delivery who is not established in Norway may have a considerable risk of being assessed for VAT on the total contract value (i.e., both on the supply of goods and installation services). Further, penalties will also normally be imposed in cases where the buyer is not registered for VAT, and interest will be calculated.

If the supplier's Norwegian customer is identified as the importer of record in the customs declaration, there is a risk that the tax authorities will conclude that the customer is not entitled to deduct the VAT incurred, even though the customer is VAT registered.³

Penalties will be based on a standard of rate 20%. If the mistake is deemed to be made by gross negligence or intentionally, the tax office has the right to increase the penalty to 40% or 60%.

³ The Norwegian tax authority: understanding of notification VAT No. 6 1982.

The general statutory limitation period for tax purposes is five years. However, in severe cases, the tax authorities may increase the tax assessment/audit period to 10 years.

General recommendations for supply and install contracts

Foreign suppliers of goods for installation in Norway should ensure that their arrangements and the VAT treatment regarding supply and install contracts is in line with the practice of the tax administration. As soon as the turnover threshold is exceeded, the supplier must register for VAT and charge VAT on its supplies of both goods and installation services. The supplier should also act as the importer of record.

Prior to entering into supply and install contracts, businesses should assess the setup and delivery terms, and whether the VAT liability is included. They should evaluate each contract based on the specific facts of the situation and the language of the contract.

Finally, for suppliers considering whether to supply goods that are to be installed or assembled in Norway, it is important to set up a plan for the import of goods and assess the potential VAT obligations before concluding the contract in order to calculate any potential cost or risks associated with the delivery.

While this article does not discuss the direct tax consequences of engaging in supply and install contracts, businesses should also consider them before entering into any such contracts. ■

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Saudi Arabia: Post-clearance audits

Saudi Customs (SC) implemented its post-clearance audit (PCA) program in 2018 consistent with Saudi Arabia's economic and social Vision 2030 plan and the National Transformation Program 2020. The PCA program quickly yielded favorable results, and within one year of the program's initiation, Saudi Customs reported that 80% of imports were clearing within 1 day, a remarkable improvement over the historically common 10 to 14 days.¹ Within 12 months of transforming its PCA function, Saudi Customs managed to revamp its internal capabilities (by 2018). Within a short period of initiating the transformation of the PCA division, Saudi Customs had done the following:



In the year 2018

- ▶ Employed more than 100 additional auditors with finance backgrounds
- ▶ Conducted over 400 audits
- ▶ Increased the number of customs duty discrepancies it identified per quarter by 16 times
- ▶ In the first and second quarter, discovered that over 60% of the companies audited had customs compliance discrepancies.
- ▶ In the third quarter doubled the performance of the first and second quarter
- ▶ Reported that the fourth quarter was five times bigger than the first quarter

In the year 2019

- ▶ In the first quarter of 2019 according to the organization, generated 24 times the discrepancies of those identified in the same period of the previous year

Saudi Customs also developed a target architecture blueprint for the business-process-driven PCA system that supports all phases of the audit life cycle. PCA auditors are now divided into desk and field audit teams, which allows for specialization and quality assurance by each team in the life cycle. A PCA targeting committee was also established and comprises senior management to identify companies to audit.

¹ Saudi Customs, "Saudi Arabia PCA Journey: Learnings of Implementing PCA Initiative Alongside 24 Hours Clearance Initiative," 1 July 2019.

There was thus an exponential increase in PCA capacity and investigations from 2018 onward by Saudi Customs.

Characteristics of the program

The objectives of the program are as follows:

- ▶ Confirm that the declared transaction value corresponds to the goods as imported and that the amount reported represents all payments to the seller, whether made directly or indirectly, including sale commissions, assists and intellectual property rights
 - ▶ Confirm that all customs information is compliant with customs requirements by examining the accounting records and workplace systems of the importer and exporter
 - ▶ Ensure the amount of revenue due has been collected
 - ▶ Ensure that goods subject to special import or export controls have been properly declared
 - ▶ Facilitate international trade movements for compliant importers
 - ▶ Develop communication and cooperation links between Saudi Customs and its customers
- Under Saudi Arabian customs law, the Saudi Customs may:
- ▶ Enter and inspect the premises subject to the audit
 - ▶ Audit records, systems, and commercial data related to customs declarations and financial statements



- ▶ Ask questions and receive information from the audited entity's officers
- ▶ Retrieve and retain commercial documents and records
- ▶ Inspect and take samples from goods and inventory

Recent insights identified by Saudi Customs from its PCA implementation

In July 2019 (one year after implementation), Saudi Customs identified its practical insights gained from implementation of the PCA program that require further evaluation to significantly increase the impact of the PCA department. Saudi Customs has since identified the following lessons learned and action items:

Lessons learned

- ▶ The fast-tracked audits did not necessarily result in actual revenue collection due to delays and appeals

- ▶ Identifying the appropriate companies to audit took time given the need to understand the market
- ▶ Incorrect reporting was critical to the health of the investigation and program
- ▶ Engagement between PCA auditors or customs officials may have been underestimated

Action items

- ▶ Combine the PCA process with the transformation of revenue management and the appeals process to enhance collections and reduce delays and appeals
- ▶ Identify appropriate companies to target for PCA in less time by using reliable historical data and engaging data analytics and artificial intelligence to identify quick wins
- ▶ Better manage PCA team performance for better visibility and to foster continuous improvement
- ▶ Explore new ways for the PCA to work in a focused manner

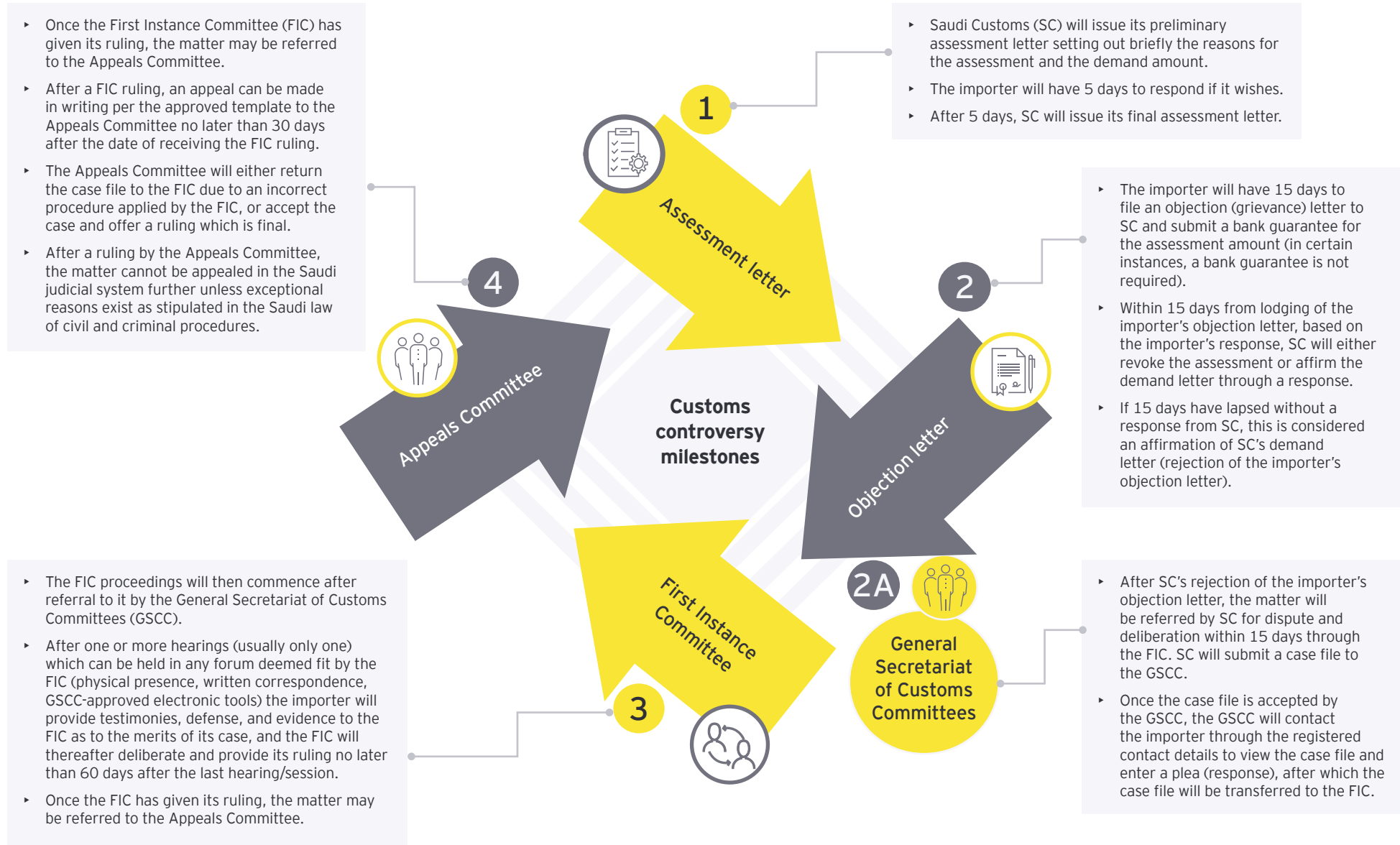
- ▶ Engage proactively with the private sector in an open, transparent and clear manner to enhance compliance levels and secure revenue
- ▶ Streamline tasks and processes through digital transformation

Significant points surrounding the PCA and dispute resolution process

Saudi Customs PCA auditors are developing stronger financial/accounting backgrounds, and response times are short and pressured. Assessment letters can be issued within approximately 15 days, with only five days of response time to preliminary findings and 15 days to the official assessment and duty demand letter. Administrative appeals can be made on two levels of escalation – the First Instance Committee (FIC) and the Appeal Committee.

Given such tight time frames, companies may not have adequate time to respond substantively or as necessary to appropriately defend their positions. Companies should therefore prepare in advance, conducting internal audits and identifying potential problems that can be addressed early. Furthermore, companies should consider having readily prepared customs defense files with preorganized teams from various divisions that are able to respond swiftly, adequately and holistically to any customs queries. Companies would also have to ensure that they comply with the timelines and processes of the established administrative procedures throughout the audit and dispute resolution process to ensure that the substance of their case or defense is not hindered due to any procedural noncompliances.

Based on our consultations with Saudi Customs, we provide below a brief snapshot of the Saudi Customs PCA and dispute resolution process:



Latest trends – 2020 to 2021

As a result of the above learnings and actions, and based on our experience in the region, we list below the latest Saudi Customs trends as observed by the EY team.

Saudi Customs has done the following:

- ▶ Increasingly cooperated with other competent authorities such as the General Authority of Zakat and Tax (GAZT) and the Ministry of Commerce and Industry, with customs valuation and foreign

purchase reconciliations or industrial exemptions as examples. GAZT and Saudi Customs are therefore increasingly sharing information with one another – for example, GAZT may refer foreign purchase reconciliations or domestic reselling prices of imported products to Saudi Customs, which may be used by Saudi Customs to assess whether the declared import value of that product might be understated. Conversely, Saudi Customs may share information about the declared import values to GAZT for a potential transfer pricing investigation by GAZT.

- ▶ Recently focused on reviewing importer eligibility to preferential treatment under certain free trade agreements, which include the Greater Arab Free Trade Agreement and the free trade agreement between the European Free Trade Association and the Gulf Cooperation Council (GCC. Saudi Customs rejected preferential treatment (or GCC national product status) on some imports due to issues such as tripartite agreements in which one of the parties is not an Arab party, the involvement of free-zone entities within the transaction or the importer's inability to establish non-manipulation of the goods en route to Saudi Arabia.
- ▶ Focused on dutiable royalty and franchise fee payments not added to the customs value at the time of import and classification of goods that attract higher customs duty. In addition, Saudi Customs is positioning to increase its risk-based profiling and monitoring of companies for flagging any customs anomalies. Furthermore, the authority is taking steps to protect its revenue base to ensure legitimate customs duty collection

and reduce revenue leakage. Based on the experiences of our clients, other typical customs issues through past PCAs over the previous year could include:

- ▶ Customs undervaluation and sustainability of related-party prices
- ▶ Failure to include royalty, franchise fee or license fee payments in the dutiable value of imported goods
- ▶ Failure to declare additional transfer pricing upward adjustments in the dutiable value of imported goods
- ▶ Failure to include additional costs in the customs value such as freight, insurance or proceeds of sale
- ▶ Use of incorrect or inappropriate HS codes and calling for additional duties on this basis
- ▶ Revised interpretations regarding the application of free trade agreements, which may lead to increased duty assessments
- ▶ Cancellation of industrial duty exemptions based on a revised interpretation of the industrial exemptions regulations and guides
- ▶ Self-correction program: To foster greater compliance, Saudi Customs also announced the launch of its self-correction program on 1 January 2020, which is a voluntary disclosure scheme aimed at encouraging importers to self-correct any past noncompliant import transactions. During the period when the program is active, importers who approach Saudi Customs to



voluntarily correct any errors in past import transactions, usually within the preceding five years, will be liable only for applicable duties and taxes due and will not be subject to the penalties that would otherwise apply if the errors were to be discovered under a PCA investigation initiated by Saudi Customs. While the period for self-correction has now already expired, it is anticipated that Saudi Customs will allow such voluntary disclosure annually or biannually. Businesses may therefore take the opportunity to review their records of import transactions over the last five years (or more, as applicable) and consider reporting any errors to Saudi Customs promptly to take advantage of the program. As penalties for errors discovered during a post-clearance audit may be as high as three times the value of the goods and may include imprisonment for certain infractions, importers may potentially stand to benefit from reviewing their records for the last five years (or longer, if applicable) to detect possible errors and voluntarily report these errors in a timely manner formally under the self-correction program (when active).

Businesses in Saudi Arabia should therefore pay more attention to their compliance profile, not just related to the customs area but also in other tax areas. In addition, as and when there are significant changes in a company's supply chain, companies should revisit the same to verify whether any of these changes may increase their risk profile for customs purposes or require additional administrative steps to ensure compliance.

Penalties for noncompliance

Importation (including attempted importation) of goods in violation of customs law constitutes smuggling and the penalties for any violations found by the audit team are specified in terms of the smuggled goods as follows:

- ▶ Where the smuggled goods are goods that are not subject to customs duties, the penalty is not less than 10% of the value of the goods and not more than their value. The importer may be subject to imprisonment for a period not less than one month and not more than one year.
- ▶ For other goods, the penalty is not less than double the customs duty payable and not more than the value of the goods. The importer may be subject to imprisonment for a period not less than one month and not more than one year.
- ▶ If the smuggled goods are subject to high customs duties, the penalty is not less than double the customs tax due and not more than double the value of the goods. The importer may be subject to imprisonment for a period not less than one month and not more than one year.

Penalties apply to importers and may include partners, financiers, sponsors, beneficiaries, brokers, clients, donors, carriers, holders and consigners of goods.

Compliance advantages

Where the audit team finds proper compliance with customs law and regulations, the following advantages may apply:

- ▶ Customs "Fast Track" program in customs ports
- ▶ Priority in all customs procedures

- ▶ Recommendation for the company to the approved economic operator program, subject to additional requirements
- ▶ Use of bank guarantee to release shipments
- ▶ Reduced frequency of manual inspection and sample analysis

Conclusion

Saudi Customs has been expanding its post-clearance audit activities and has been active in approaching multinationals and local importers for customs audits. The audit visits have been with short notice and focused on a wide range of issues, including examining the transaction value, financial statements, nonfinancial records, payment terms and customs duty payments. As penalties for errors discovered during a post-clearance audit may be as high as double the value of the goods and may include imprisonment for certain infractions, importers may potentially stand to benefit from reviewing their records for the last five years (or longer, if applicable) to detect possible errors and to explore viable options. ■

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Technology



Technology

Are you running an analogue supply chain for a digital economy?
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Is data the next port of call?
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Are you running an analogue supply chain for a digital economy?

COVID-19 has exposed long-standing weaknesses in how we make and sell goods. The solution is digitization and automation, in four steps. Read the article on [ey.com](https://www.ey.com) ■





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Tax Alerts

Americas

Canada

- ▶ Ontario issues budget 2020-21 (09.11.2020)

Costa Rica

- ▶ Costa Rica's Executive Branch may extend period goods may stay in a tax warehouse (22.02.2021)
- ▶ Costa Rica's President and the Ministry of Finance publish "guidelines for the implementation of treaty provisions and agreements for the importation of goods" (22.02.2021)
- ▶ Costa Rica's President and Minister of Finance publish regulation updating criteria for selecting people and items subject to customs control (20.11.2020)

Mexico

- ▶ US and Mexico renew competent authority agreement on unilateral APAs for maquiladoras (20.11.2020)

OECD

- ▶ OECD publishes Revenue Statistics in Africa 2020 (14.12.2020)

US

- ▶ USTR releases findings of Section 301 investigation on DST regimes of Austria, Spain and the UK, and 301 findings on Vietnam's currency valuation practices (21.01.2021)
- ▶ USTR announces findings in Section 301 investigations on DSTs adopted by India, Italy, Turkey, suspends punitive tariff actions on French origin goods (13.01.2021)
- ▶ USTR announces modifications to tariffs on EU goods under Section 301 including punitive tariffs on new items of French and German origin (05.01.2021)
- ▶ US and Mexico renew competent authority agreement on unilateral APAs for maquiladoras (20.11.2020)
- ▶ EU publishes list of US products subject to additional duties following WTO authorization (16.11.2020)

US continued

- ▶ EU imposes countermeasures on US origin goods (11.11.2020)
- ▶ USTR suspends GSP for certain Thai origin goods, Commerce issues preliminary determination on Vietnam CVD case (10.11.2020)

Asia-Pacific

Asia-Pacific

- ▶ Asia-Pacific countries sign Regional Comprehensive Economic Partnership (RCEP) Agreement (24.11.2020)

OECD

- ▶ OECD publishes Revenue Statistics in Africa 2020 (14.12.2020)

Thailand

- ▶ USTR suspends GSP for certain Thai origin goods, Commerce issues preliminary determination on Vietnam CVD case (10.11.2020)

Vietnam

- ▶ USTR releases findings of Section 301 investigation on DST regimes of Austria, Spain and the UK, and 301 findings on Vietnam's currency valuation practices (21.01.2021)
- ▶ USTR suspends GSP for certain Thai origin goods, Commerce issues preliminary determination on Vietnam CVD case (10.11.2020)

Europe, Middle East, India and Africa

Africa Union

- ▶ Africa Union launches Africa Continental Free Trade Area: Status of trading among African countries (10.02.2021)

Austria

- ▶ USTR releases findings of Section 301 investigation on DST regimes of Austria, Spain and the UK, and 301 findings on Vietnam's currency valuation practices (21.01.2021)

Belgium

- ▶ Belgium implements EU plastics tax measures (02.12.2020)

EU

- ▶ USTR announces modifications to tariffs on EU goods under Section 301 including punitive tariffs on new items of French and German origin (05.01.2021)
- ▶ UK and EU reach trade agreement (29.12.2020)
- ▶ European Commission adopts new regulation regarding stricter Authorized Economic Operator compliance record criterion (21.12.2020)
- ▶ European Court of Justice rules payments made for exclusive distribution right are to be added to customs value (20.11.2020)
- ▶ EU publishes list of US products subject to additional duties following WTO authorization (16.11.2020)
- ▶ EU imposes countermeasures on US origin goods (11.11.2020)

Egypt

- ▶ Egypt updates its customs laws (03.12.2020)

France

- ▶ USTR announces findings in Section 301 investigations on DSTs adopted by India, Italy, Turkey, suspends punitive tariff actions on French origin goods (13.01.2021)
- ▶ USTR announces modifications to tariffs on EU goods under Section 301 including punitive tariffs on new items of French and German origin (05.01.2021)

Germany

- ▶ USTR announces modifications to tariffs on EU goods under Section 301 including punitive tariffs on new items of French and German origin (05.01.2021)

India

- ▶ USTR announces findings in Section 301 investigations on DSTs adopted by India, Italy, Turkey, suspends punitive tariff actions on French origin goods (13.01.2021)

Italy

- ▶ USTR announces findings in Section 301 investigations on DSTs adopted by India, Italy, Turkey, suspends punitive tariff actions on French origin goods (13.01.2021)
- ▶ Italian Government proposes changes to tax on plastic items (24.11.2020)

Kenya

- ▶ Kenya's High Court rules that retrospective application of a tax law is not unconstitutional but must be practical and reasonable (10.12.2020)

OECD

- ▶ OECD publishes Revenue Statistics in Africa 2020 (14.12.2020)

Spain

- ▶ USTR releases findings of Section 301 investigation on DST regimes of Austria, Spain and the UK, and 301 findings on Vietnam's currency valuation practices (21.01.2021)

Turkey

- ▶ USTR announces findings in Section 301 investigations on DSTs adopted by India, Italy, Turkey, suspends punitive tariff actions on French origin goods (13.01.2021)

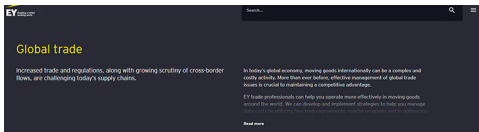
UK

- ▶ USTR releases findings of Section 301 investigation on DST regimes of Austria, Spain and the UK, and 301 findings on Vietnam's currency valuation practices (21.01.2021)
- ▶ UK and EU reach trade agreement (29.12.2020)
- ▶ UK Government issues details of new Plastics Packaging Tax effective 1 April 2022 (16.11.2020)

Zambia

- ▶ Zambian Government issues 2021 Tax Amendment Acts and Regulations (19.01.2021)

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