

TradeWatch

A large cargo ship is shown at night, illuminated by bright yellow lights. A red container is being lifted by a yellow crane. The ship's deck and various pieces of equipment are visible, creating a complex industrial scene.

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Building a better
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Is there any certainty in today's challenging trade times?

In the world we live in today, the goods we consume and the services we enjoy would not exist without global trade. To keep trade flowing efficiently and effectively, one needs to continually manage several variables including changing geopolitics, COVID-19 challenges, rising nationalism and increasing trade protectionism around the world. These factors have prompted an increased focus on operating models, supply chains and manufacturing footprints, and is making multinational corporations (MNCs) reimagine business strategies in part to improve overall resilience.

Ongoing trade tensions have resulted in punitive tariffs imposed by the US on goods originating from both China and the European Union (EU) under Section 301 of the Trade Act of 1974. The underlying issues between the US and China include – among others – a dispute over China's policies on intellectual property (IP), technology and innovation. With regards to the EU, the issue mainly seems to relate to a dispute about aviation subsidies and to the digital services tax several EU countries have implemented or are planning to implement. The punitive tariffs are imposed on a wide range of goods, and China and the EU have retaliated with punitive tariffs on US originating goods. Add Brexit and the COVID-19 pandemic into the mix, and the result is an extremely complex and volatile global trade environment.

Diversification and relocation are not a new phenomenon

Increasing labor costs in China – and the attractiveness of the Asian market – has already led companies to think more strongly about diversification and the relocation of manufacturing locations. Ongoing trade tensions and COVID-19 may simply act as accelerators. For example, the “China-plus-One” strategy originated more than a decade ago, when MNCs with a manufacturing footprint in China (only) started to expand to alternative locations in Asia.

Reasons for the move cited benefits from lower labor cost, and from a risk diversification perspective, being less vulnerable and more resilient to supply chain disruption. Countries in the Southeast Asia region (many of them members of the Association of Southeast Asian Nations (ASEAN)) benefited from the diversification. The ongoing US-China trade tensions and now the COVID-19 pandemic have also cast doubt on the fragility of supply chains, and MNCs are again looking into relocating manufacturing activities from China to ASEAN countries.

Vietnam, one of the 10 ASEAN countries, is often mentioned as a big winner. The ongoing trade tension between the US and China has already resulted in MNCs – which supply the US market –



relocating to Vietnam. COVID-19 may increase this number. One of the key drivers is the low labor cost, but from a wider supply chain and trade perspective, Vietnam has notably signed a raft of international trade deals. Examples are the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the recently ratified free trade agreement (FTA) with the EU – which will enter into force on 1 August 2020 – and the Generalized Scheme of Preferences (GSP) status. The question is how long Vietnam's status as big winner will last, as Vietnam recently became subject to an investigation under Section 301 of the 1974 Trade Act, which may result in punitive tariffs being imposed by the US on Vietnamese goods.

Changing footprints goes beyond location

Changing the manufacturing footprint, however, is complex, and there are many considerations. To name just a few, MNCs must:

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

As a result, MNCs often start with a partial relocation. This could mean that materials and components used in the manufacturing process originate from different countries. Importantly, MNCs

therefore have to make sure that the relocation of manufacturing footprints allows them to obtain the right (non) preferential origin. This, together with the tariff classification and value, is a determining factor on which tariff rates and measures (such as anti-dumping duties, safeguard measures, quotas) are applied.

Furthermore, origin is important under an FTA, as this can result in a preferential treatment and being eligible for lower – or even 0% – tariff rates in the country where goods are shipped to. For example, under the EU-Vietnam FTA, the EU would liberalize the majority of its imports originating from Vietnam from day one, and almost all imports will be tariff-free after seven years. This could be a significant competitive advantage for goods originating from Vietnam since imports originating from China, for example, do not have this preferential treatment.

Advance rulings on origin: an important piece of the puzzle

World Trade Organization (WTO) member countries are required to issue advance rulings under article 3 of the Trade Facilitation Agreement related to the tariff classification and (non-preferential) origin of imported goods. When MNCs use materials or components originating from different countries and are unsure about the (non-preferential) origin or tariff classification of their goods, advance rulings may be useful. The validity depends on the country of importation. In some countries, like Canada and the US, the advance ruling is valid until revoked or modified, whereas in the EU, a ruling on origin

(Binding Origin Information (BOI)) is generally valid for three years from the date of issue and is legally binding throughout the EU, regardless of which EU country issues it. The terms applied to the requester vary from country to country. MNCs established outside of the EU may for instance also apply for BOI decisions for imports in the EU, via appointing an indirect customs representative, which is established in the EU (e.g., a customs broker or freight forwarder). Encouraged by the WTO, the rulings are made public for transparency reasons in an increasing number of countries, but in most cases all confidential information is protected.

Advance rulings can be greatly appreciated measures for MNCs who want legal certainty before goods arrive in the country of importation. It is important to note there are requirements and administrative procedures to be fulfilled. However, certainty is always welcomed for MNCs reimagining diversification in their manufacturing footprints, especially during today's challenging trade times. ■

For additional information please contact:

Sidney Rouwenhorst
+ 31 88 40 72473
sidney.rouwenhorst@nl.ey.com

EU-Vietnam: Free Trade Agreement and Investment Protection Agreement

On 30 June 2020, the European Union (EU) and Vietnam signed a Free Trade Agreement (FTA)¹ and an Investment Protection Agreement (IPA). The FTA entered into force on 1 August 2020 and liberalizes the majority of the import duties imposed by the EU and Vietnam for goods originating from the other country. The EU will liberalize 71% of its imports from Vietnam at entry into force and 99% after 7 years. Vietnam will liberalize 65% of its imports from the EU at entry into force and the remaining trade – with the exception of a few products – will be liberalized after 10 years. According to the World Bank, the FTA is likely to have a more significant

impact on Vietnam's economy than any other FTA it has signed.² The EU, which has traditionally had a negative trade balance with Vietnam, is expected to see benefits beyond increased bilateral trade flows. As part of the FTA, Vietnam is required to align closely with international motor vehicle standards – a move that will allow EU car manufacturers to export vehicles without undergoing additional testing and certification. Further, EU companies will also be allowed to compete for government tenders from selected authorities.

This article summarizes the application of the FTA and provides more information about how to benefit from the tariff preference under the FTA.

Key elements of the Free Trade Agreement

Trade in goods

The FTA is mostly aimed at duty-free trade. It contains full dismantling of nearly all tariffs except for a few tariff lines that are subject to duty-free tariff rate quotas. On importation into Vietnam of products originating in the EU, sectors that

will benefit from the immediate removal of tariffs are machinery and appliances, pharmaceuticals, chemicals, textiles and fisheries (salmon, halibut, trout and rock lobster). Tariffs on car parts, motorcycles, frozen pork meat, food preparations, wines and spirits will be dismantled over 7 years; tariffs on cars, chicken and beer will be dismantled over 10 years. Vietnam will maintain existing World Trade Organization tariff rate quotas for refined sugar, salt and eggs, albeit with a reduction of the in-quota rate to zero over 10 years.

Trade in services

The FTA will provide access to a wide range of services fields of business, computer, postal, social, higher education, environmental, distribution services, financial services, maritime transport services, air transport services and telecommunications.

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

Removal of regulatory barriers

Non-tariff barriers are addressed by the FTA as well, which facilitates the access of Vietnamese companies to the highly regulated EU market and the other way around. The EU and Vietnam will enhance customs cooperation to simplify, harmonize, standardize and modernize trade procedures in an effort to cut transaction costs for companies. These enhancements will affect technical regulations,

1 Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam, [OJ L 186/3, 12.6.2020](#), p. 3-1400.

2 Vietnam is expected to see an additional 2.4% increase in GDP relative to the baseline scenario by 2030, with manufacturing sectors such as apparel, textiles, food, beverages, and tobacco reaping the greatest benefits. In particular, Vietnamese authorities expect apparel exports to increase exponentially from now to 2025, and register an additional 67% growth compared to a non-EVFTA scenario.



standards, conformity assessments, transparency and market surveillance.

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

Preferential origin and origin documentation

Obtaining preferential origin

The FTA provides, on a reciprocal and mutually advantageous basis, benefits for companies involved in supply chains between the EU and Vietnam. The following conditions must be met for goods exported from the EU to benefit from preferential treatment at the Vietnamese border or vice versa. Goods must:

1. “Originate” in the EU or Vietnam
2. Be accompanied by appropriate origin documentation
3. Meet certain additional requirements, for example, the principle of non-alteration applies (see below)

Exporters using inward processing schemes for subsequent export to Vietnam or to the EU may benefit from suspension or reimbursement of duties applied to non-originating inputs used in the manufacture, if they have complied with the Product Specific Rules (e.g., duty drawback is allowed).

Origin documentation under the FTA and GSP

Products originating in the EU shall, on importation into Vietnam, benefit from the tariff preference of the FTA upon submission of statements on origin made out by registered exporters (e.g., registration in the Registered Exporter (REX) system) or by any exporter for consignments the total value of which does not exceed EUR6,000. Certificates of origin (EUR.1) and origin declarations will not be issued or made out in the EU to benefit from the preferential tariff treatment in Vietnam.³

Under the FTA, Vietnamese exporters can apply for EUR.1 certificates for the first two years after the FTA enters into force on 1 August 2020. Thereafter, origin declarations can be obtained under the “Approved Exporter” mechanism. Approved exporters can make use of self-certification, which is comparable to the Registered Exporter (REX) system. Upon application of the “Approved Exporter” system, Vietnam has to inform the EU. Vietnamese exporters (importers in the EU) are also entitled to apply the lowest of the Generalized Scheme of Preferences (GSP) duty rate or the EU-Vietnam FTA duty rate. This rule applies automatically after entry into force of the EU-Vietnam FTA and shall apply for seven years. It is worthwhile to mention that the EU-Vietnam GSP duties are terminated as of 1 January 2023. To benefit from the GSP duties, exporters should comply with the preferential origin GSP rules and make out a statement on origin. Only a registered exporter (e.g., registration in the REX system) is allowed to make out a statement of origin. Form A certificates are no longer issued by the Vietnamese customs authorities as of 1 July 2020,

except for exceptional cases (e.g., the exporter’s REX registration is pending approval) in case additional requirements should be fulfilled.

Over the last two months after the FTA entered into force, it appeared that the guilloche overprint of EUR.1 certificates issued in Vietnam were blue instead of green. Importers in the EU using these “blue” EUR.1 certificates were, at first, not eligible for beneficial treatment under the FTA. Meanwhile, the European Commission established a transition period that allows importers to use “blue” EUR.1 certificates. This transition period applies to EUR.1 certificates with a guilloche overprint in blue with a serial number from AA000001 to AA100000 and ends as soon as “green” EUR.1 certificates of the AB series are available by 31 December 2020.

Non-alteration

The principle of non-alteration applies to determine the origin of the goods, which means that the goods can transit through third countries, as long as they have not been altered, transformed or subject to operations other than preserving them in good condition or adding/affixing marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements of the importing countries. Storage of goods or consignments may take place provided they remain under customs supervision in the country or countries of transit. The splitting of consignments may take place where carried out by the exporter or under his responsibility, provided they remain under customs supervision in the country or countries of splitting.

³ Notice to exporters concerning the application of the REX system in the European Union for the purpose of its Free Trade Agreement with Vietnam, [OJ C 196, 11.6.2020](#), p. 16-16



If there is any doubt, the importing party may request the declarant to provide evidence of compliance, which may be given by any means, including:

1. Contractual transport documents such as bills of lading
2. Factual or concrete evidence based on marking or numbering of packages
3. Any evidence related to the goods themselves
4. A certificate of non-manipulation provided by the customs authorities of the country or countries of transit or splitting, or any other documents demonstrating that the goods remained under customs supervision in the country or countries of transit or splitting

ASEAN cumulation

The FTA provides for bilateral cumulation. Further, the FTA provides cumulation with South Korea in relation to fabrics used for producing garments after complying with certain administrative requirements. Vietnam will also benefit from cumulation with ASEAN countries with which the EU has an FTA in force for two fishery goods: squid and octopus. A review clause foresees the possibility of agreeing to extended cumulation for more goods and/or more countries with which both parties have an FTA in the future.

Binding Origin Information and Binding Tariff Information

If materials and components used in the manufacturing process originate from multiple countries, it can be difficult for companies to determine the right origin. Companies who simply want legal certainty before goods arrive in the EU may apply for an “advanced ruling” from the customs authorities, such as the Binding Origin Information (BOI) or Binding Tariff Information (BTI) decision, which, if granted, will provide certainty for three years.

Binding Origin Information

If it can be proven that the goods originate from Vietnam, a BOI decision provides certainty with respect to the origin of a product or a product category. BOI applications can be submitted electronically and where such a system is not available, it can be submitted in paper form. The BOI application must include several elements, including:

- ▶ General information of the applicant
- ▶ Description of the goods (e.g., commercial name, seize, color, marks)
- ▶ Tariff classification
- ▶ Information enabling the determination of origin (e.g., materials and components used, including origin, tariff classification, value and weight)
- ▶ Operations or the processing undertaken
- ▶ Rule of origin to be applied
- ▶ Origin envisaged for the good
- ▶ Data to be treated as confidential
- ▶ Ex-works price

The existence of a BOI decision does not exempt the importer from the requirement to provide proof of origin upon the arrival of the goods in the EU.

Binding Tariff Information

Companies can file for a BTI decision to obtain certainty regarding the applicable tariff for a good or a category of goods. BTI applications have to be filed electronically through the EU Customs Trader Portal (note that a few countries host a national portal). The BTI application must include several elements, including:

- ▶ General information of the applicant
- ▶ Type of transaction (e.g., import or export)
- ▶ Description of the goods (e.g., commercial name, seize, color, marks) including images or samples, if possible
- ▶ Data to be treated as confidential

Although it is generally the responsibility of the applicant to provide all information, a laboratory analysis may be used to determine the correct classification, due to the technical and complex nature of some goods.

Actions for businesses

To benefit from the preferential duty treatment under the FTA, companies must align their origin management with the conditions stated in the FTA. Businesses should work with their local tax professionals to:

1. Assess whether the goods exported from the EU to Vietnam or vice versa have obtained preferential origin
2. Map and visualize the exported goods to Vietnam/ imported from Vietnam by using customs analytics, to calculate all potential duty savings under the FTA

3. Identify the different stakeholders for origin management in current supply chain setup of companies, especially with regard to identifying the exporter required to print the origin statements
4. Prepare the application as registered exporter
5. Work to optimize their supply chain enabling them to make use of the FTA (or other free trade agreements) by identifying potential opportunities for simplifications and standardization and set out a road map to implement these optimizations
6. Prepare to apply for BTIs or BOIs ■



For additional information please contact:

Anh Tuan Thach
+ 84 28 3629 7366 | anh.tuan.thach@vn.ey.com

Tram van Bui
+ 84 24 3211 6022 | tram.van.bui@vn.ey.com

Martijn Schippers
+ 31 88 40 79160 | martijn.schippers@nl.ey.com

Walter de Wit
+ 31 88 40 71390 | walter.de.wit@nl.ey.com

Sustainable trade: Supporting the green agenda



As the international trading system weighs up the best ways to recover from the COVID-19 pandemic, countries, businesses and individuals are looking at how they can help ensure that their impact on the environment is made more sustainable going forward. In this article, we look at the major initiatives currently being considered around the world and what businesses can do in support of being sustainable.

Companies, in looking to green their operations and embed sustainability, face multiple challenges and drivers that incentivize different behaviors – including from suppliers, consumers and employees. They also seek to comply with mandatory and voluntary government and international initiatives. Managing these can be further complicated by companies' operations as they move products, services and people across borders.

Looking forward to the 26th UN Climate Change Conference (COP26) and the global aims of meeting the objective of the UNFCCC Paris Agreement to limit the increase in the world's warming to below 2°C, businesses are increasingly focused on contributing toward the decrease in carbon emissions, the promotion of technological advances, more environmentally friendly patterns of consumption and production, and take active measures to restore the biodiversity loss in our forests and oceans.

International trade agreements

At the international level, the frameworks governing environment and trade have historically been separate. The World Trade Organization and free trade agreements (FTAs) sit on the trade side, and Multilateral Environment Agreements (of which the Paris Climate Agreement and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) are two examples) looking to the environment on the other. Keeping them separate has meant that the power of meeting common objectives has not been achieved.

More recently, some countries like those in the EU have been pursuing more ambitious environmental and labor chapters as part of their FTAs. There are also ongoing negotiations for an Agreement on Climate Change, Trade and Sustainability (ACCTS) being led by New Zealand, Costa Rica and Norway. However, more can and should be done to better align trade and environmental behavior changes.

Countries are also looking at what can be done unilaterally through their trade policies. For example, the UK Government, as part of the UK Global Tariff, has eliminated tariffs on a large number of environmental products including solar panels, wind turbines and the like.

Regulatory and tracing initiatives

For a number of years, civil organizations and consumers have been holding companies accountable for the ethical quality of their supply chains; increasingly these concerns are being addressed by governments as they look to drive policy outcomes. Legislative action can be both



product-specific, such as the US-led Kimberley Process for diamond certification and systemic such as the UK's Modern Slavery Act, which is intended to end slavery and human trafficking and looks to ensure the production processes within a supply chain are free from labor violations.

Companies need to be aware that this is an area that is evolving at a rapid pace, with several new initiatives being proposed by governments around the world. These include:

- ▶ **EU Conflict Minerals Regulation**
- ▶ **Switzerland's Responsible Business Initiative**
- ▶ **The UK's reducing deforestation in supply chains**

Even more wide-ranging rules could be on their way with the **EU Sustainable Products Initiative**. This initiative, which will revise the **Ecodesign Directive** and propose additional legislative measures as appropriate, aims to make products placed on the EU market more sustainable

Reporting requirements

International efforts on climate-related risk reporting has largely been led through the Taskforce on Climate-related Financial Disclosures (TCFD), which is part of the G20's Financial Stability Board.

In the UK, the Bank of England and the Prudential Regulation Authority (PRA) have been pioneering many of the approaches set out in the TCFD's recommendations. Since 2019, they have issued additional guidance on their expectations and leading practice across the four main areas of reporting, which include governance, risk management, scenario analysis and disclosure.

Currently, the obligations apply only to UK-based building societies, banks and insurers but the UK Government has announced that it is intending to extend the coverage to all listed companies and large asset holders by 2022, which will have down-stream impacts for many businesses.

New financial incentives are also being introduced, including the EU taxonomy for sustainable activities by the European Commission's Technical Expert

Group on sustainable finance. This is designed to assist financial companies by redirecting capital flows toward more sustainable assets across sectors that meet certain climate change mitigation and adaptation objectives of the EU.

Implications for businesses

As business are looking at their supply chains in greater depth as a result of the COVID-19 pandemic, they can embed sustainability criteria by managing risks and adopting corporate commitments to human rights, ethics, the environment and the communities from which they source goods and services.

These include:

- ▶ Monitoring and measuring of environmental impact of cross-border operations
- ▶ Managing compliance and governance frameworks
- ▶ Multiple sustainable product standards (mandatory and voluntary)
- ▶ Eco-labelling
- ▶ Implementing sustainable procurement systems
- ▶ Reducing the impact of transport emissions ■

For additional information please contact:

Sally Jones
+ 44 7900 703 113 | sally.jones@uk.ey.com

George Riddell
+ 44 7385 344 565 | george.riddell@uk.ey.com

How trade finance can operate effectively in the wake of COVID-19

The effects of the COVID-19 crisis on trade finance have been immense. Organizations are battling to survive the impact of the pandemic and are anxious to determine how they can persevere during this tumultuous time. Find the article on [ey.com](https://www.ey.com). ■



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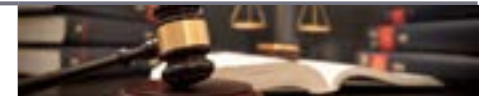
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Brazil: Tax reform may impact customs special regimes

Brazil's proposed Contribution on Goods and Services (CBS for its Portuguese acronym) could apply to taxpayers that were not previously subject to Programa de Integração Social (PIS) and Contribution for the Financing of Social Security (COFINS) contributions due to their participation in customs special regimes.

Background

On 21 July 2020, Brazil proposed a bill that would replace existing PIS and COFINS contributions with CBS. The new tax, which is intended to function as a federal value-added tax (VAT), would apply to local sales (gross revenue) and imports of goods and services.

The CBS would be levied at a flat rate of 12% on gross revenue (reduced by taxes due on revenue, such as the State Value Added Tax – ICMS, and the Municipal Service Tax – ISS, as well as unconditional discounts). It is intended to work as a federal value-added tax (VAT) in the sense that full input tax credit would be available. Currently, the combined standard rate for PIS and COFINS upon importation is 11.75%.

Besides other provisions, the bill would eliminate or modify several tax incentives and regimes, aiming to simplify the Brazilian tax system.

Special regimes impacted by CBS proposal

Currently, Brazil has several special regimes that either suspend or exempt eligible taxpayers from certain taxes, including PIS and COFINS Contributions, upon importation, provided the taxpayers meet the regime's requirements.





In keeping with the proposed elimination of PIS and COFINS Contributions, the bill would amend Brazil's special regimes to remove references to those taxes. It would not, however, revise those regimes to exempt eligible taxpayers from CBS or suspend CBS's application. As a result, certain regimes would lose effect for CBS purposes. Examples of these regimes include:

- ▶ Special Regime for the Acquisition of Capital Assets (RECAP) for preponderantly exporting companies
- ▶ Special Incentive Regime for Infrastructure Development (REIDI)
- ▶ Special Regime for the Reintegration of Taxes for Exporting Companies (REINTEGRA)

Proponents of leaving the special regimes unmodified for CBS purposes note that taxpayers could offset CBS paid against other taxes due or claim a refund. As such, the exemptions or suspensions that would otherwise apply under the special customs regimes would be unnecessary from the Brazilian Government's standpoint. Nevertheless, taxpayer's cash flow could still be disrupted if the CBS refund process is slow or complicated. Cash-flow disruptions could particularly affect sectors with large investments, as they would not have budgeted for this issue.

The bill, however, would retain the Manaus Free Trade Zone and special customs regimes that allow for the suspension of the import duty and the federal excise tax (e.g., RECOF). These regimes could still lead to the suspension of the CBS.

Looking ahead

The National Congress must still debate the bill and could amend it significantly as part of the legislative process. If enacted, the CBS would be effective the first day of the sixth month following enactment of the law, and the PIS and COFINS would cease to exist.

When the bill was presented by the Federal Government, National Congress included it on a regime of urgency for debate and amendments. However, recently, the Congress have just excluded the bill from such status. This exclusion, per se, does not necessarily mean that the subject lost relevance but could imply that this process of discussions and amendments will take longer than initially expected.

Provided the special regimes modifications remain the same for CBS purposes, companies will need to determine the real effects of having CBS charged on their purchases. They should also consider reviewing their procurement forecast to determine if they could request suspensions/exemptions for anticipated orders under the current special customs regimes while the potential reform is debated. ■

For additional information please contact:

Fernanda Salzedas
+ 55 11 2573 4225
fernanda.salzedas@br.ey.com

Gabriel Martins
+ 55 21 3263 7201
gabriel.martins@br.ey.com

Ian Craig
+ 55 21 3263 7362
ian.craig@br.ey.com

Cesar Finotti
+ 55 11 9690 06396
cesar.finotti@br.ey.com

Mexico: Changes to customs rules for 2020 impacting maquiladoras and other regimes



Recent changes to the Mexican VAT and excise tax certification program (VAT certification) will significantly impact companies' operations.

The VAT certification was originally created as a mechanism for the Mexican Government to identify and provide certain customs benefits to reliable companies importing goods temporarily under special programs. But, due to changes in the customs rules, these benefits are being reduced and instead being granted to those importers in the Authorized Economic Operator (AEO) program. Additionally, both the export volume requirements and certification fees are increasing in order to utilize the temporary import program.

Background

Since 2015, temporary imports performed by IMMEX companies in Mexico (formerly known as IMMEX maquiladoras program), and those conducted under fiscal deposit for the automotive industry, bonded warehouse and strategic bonded warehouse customs special programs, are subject to 16% VAT and excise tax.

At that time, the change was motivated by, among other things, the recommendations of the OECD on Base Erosion and Profit Sharing (BEPS) report which tends toward the general elimination of exemption regimes and specifically mentions the IMMEX regimes, and to prevent companies from failing to comply with their VAT and excise tax payment obligations when the temporarily imported goods are ultimately intended for the Mexican market.

Nonetheless, the Mexican VAT Law contemplates the possibility for companies using these temporary customs regimes to apply a tax credit of 100% of the VAT and excise tax payable upon the temporary importation of goods, to the extent that they previously obtain a VAT certification from the tax authorities.

Importers with the VAT certification are classified as “AAA,” “AA” and “A.” A higher classification gives the importer additional benefits. Until before the publication of the amendments in July, the certification also contemplated a total of 22 additional benefits, such as the extension of the period of permanence of the goods in Mexico from 18 to 36 months, accelerated processing of VAT refunds and the ability to implement certain virtual exportations for the transfer of imported goods to other Mexican residents without the need to physically export them.

To date, there are around 6,300 companies in Mexico that temporarily import goods into Mexico under special customs programs, and almost half of them are VAT/excise tax certified companies.

Changes made by the amendments

Publication of the changes took affected importers by surprise as the Mexican Government did not make an advance publication of the changes as it had been doing in recent years.

The Mexican Government had concerns around the potential misuse of the temporary import program, resulting in the scaling back of benefits granted under the program. With these changes, the authorities expect to have better control and visibility of the companies importing goods temporarily under special customs programs, such as IMMEX.

The following table shows the number of eliminated benefits of the VAT/excise tax certification, as well as those that were relocated to the AEO program.

Benefits before the amendments	Benefits eliminated	Benefits relocated to the “AEO” programs	Benefits remaining
22	10	7	5

Most of the changes will take effect upon the renewal of the certification. According to Customs Rules, companies must renew their VAT certification every one, two or three years, depending on the category of their certification A, AA and AAA, respectively. With this in mind, most companies will be renewing their VAT/excise tax certification by the end of 2020.

When considering what benefits remain and which were eliminated, the main benefit of the VAT certification, the possibility of obtaining a 100% VAT and/or excise tax credit on temporary imports, remains intact.

Of the benefits that were eliminated, the most significant are:

- ▶ Expedited terms for VAT refunds (10 days for “AAA,” 15 for “AA” and 20 for “A”)
- ▶ Automatic registration in importers/exporters’ registry for specific sectors
- ▶ Voluntary disclosure processes to correct customs irregularities
- ▶ Benefit to file monthly consolidated pedimentos, in certain cases

Finally, to round out the changes, the following benefits will now be exclusive to companies that have AEO programs:

- ▶ Term extended from 18 to 36 months, to keep temporarily imported goods in the country
- ▶ Possibility to correct certain irregularities without the authorities suspending the importers and exporters of records
- ▶ No obligation to prepare and deliver value manifests to inform the methodology used to determine the customs value of the goods, for each operation
- ▶ Possibility of filing “V5” virtual customs declarations to transfer and deliver temporarily imported goods to other non-IMMEX companies in Mexico, without having to physically export the goods outside of Mexico (the non-IMMEX company files a virtual permanent importation)

As a result of the above, it is expected that many companies will seek to register under the AEO program, a supply chain security program similar to that of C-TPAT in the US, to preserve some benefits currently enjoyed, as well as to continue being considered as a reliable company by the tax authorities.

The AEO registration process in Mexico is complex. The process requires the implementation of very strict procedures and security controls, which are evaluated by the Mexican customs authorities. On average, the process of implementing the controls and the application and evaluation procedures could take from 8 to 12 months.

Obligation to export at least 60% of temporarily imported goods

Similarly, the Mexican Government modified the wording in the customs rules of one of the most important obligations to obtain and maintain VAT/excise tax certification, which is to export at least 60% of the goods that are temporarily imported into the country.

In this sense, the new rule for calculating 60% is stricter, making it more difficult for companies to comply with the main export obligation.

Under the new wording, companies may struggle to qualify to obtain or maintain a VAT/excise tax certification and, as a result, they will have to pay the 16% VAT or the applicable excise tax when they temporarily import goods into the country.

Payment of annual fees for the use of the VAT/excise tax certification

As part of the amendments, it is also indicated that the certified companies will be obligated to make an annual payment of approximately USD1,300 for fees related to the use of their certifications. Failure to pay on time could lead to the cancellation of the certification.

Moreover, the Mexican Government recently published a notice informing the trade that certified companies were obliged to make this annual fee payment at the time they obtained their original certification. While this has caught some companies by surprise, most companies are making the retroactive payment of fees including interests and surcharges to avoid being questioned by the authorities, and to be able to continue applying the main benefit of the VAT credit, which consists in obtaining a 100% credit of the import VAT.

Conclusion

As a result of these changes, it is critical for companies to evaluate the impacts to their operations and weigh the potential of becoming AEO certified as well. With the increased enforcement activities, companies are well advised to carefully review their compliance programs. ■



For additional information please contact:

Roberto Chapa
+ 1 212 773 6790 | roberto.chapa@ey.com

US: Customs issues guidance on Section 321

Section 321 of the of the Tariff Act of 1930 as amended, codified as 19 U.S.C. § 1321 is the US statute that provides for the duty-free admission of a shipment of articles imported by one person on one day, provided the entered value of the goods does not exceed USD800. This provision, also known as de minimis, is frequently utilized by the retail and e-commerce companies. U.S. Customs and Border Protection (CBP) issued new guidance, in the form of an Internal Advice Binding Ruling, regarding the use of this provision.¹

Background and facts

Global Trade Solutions (GTS), a customs house broker, imports goods under the Section 321 exemption, listing a nonresident importer of record and nonresident consignees. Shipments are sent to Amazon Fulfillment Distribution Centers (AFDC) for resale.

In August 2017, CBP denied the release of a shipment, which consisted of multiple house air waybills (HAWB) consolidated under one master air waybill (MAWB). CBP noted the shipment could not be released as the consignee addresses were outside of the US, rendering them invalid pursuant to Custom Directive 3550-079A, which states ultimate consignees are required to reside in the US.

GTS countered CBP's position by asserting that if all HAWBs, consolidated under the MAWBs, are valued less than USD800, they are eligible for Section 321 duty exemption.

The question before CBP was whether importations by a nonresident importer, sent to a US warehouse for resale, are eligible for treatment under Section 321.

CBP's analysis

When reviewing the applicability of the USD800 de minimis threshold for "one person on one day," Customs will first consider either the owner or purchaser of the shipment. In the presented scenario, the goods are imported by a nonresident importer, with no sale occurring to a US customer at time of entry. Further, the ultimate consignees listed on the HAWBs show foreign addresses and entities. As such, it is presumed that the foreign shipper (i.e., the nonresident importer) is the owner of the goods at time of entry.

As noted in CBP's initial analysis in rejecting shipments in August 2017, the ultimate consignee must be a US entity, with a US address. In the event



¹ See [H290219](#) (28 July 2020)

the ultimate consignee is not known at the time of entry, as in this instance where the foreign shipper retains ownership of the goods until resale, the ultimate consignee will be the proprietor of the US premises where the shipments are delivered to.²

It should be noted that as there is a clear and defined owner in the present scenario, CBP will not require the consignee or ultimate consignee to take on the responsibility of an importer.

With the owner of the goods and ultimate consignee established (the foreign shipper and AFDC, respectively), CBP contemplated which entity the “one person” provision applied to. As there is a clear owner of the goods at time of entry, CBP held that shipments covered by individual airway bills with the same foreign owner should be aggregated to determine if the USD800 *de minimis* threshold is exceeded. In instances where additional owner or purchaser information is not provided to CBP, the consignee and ultimate consignee (in this scenario, AFDC), is the entity used to determine whether or not the one person on one day Section 321 *de minimis* threshold is exceeded.

Implications for importers

The ruling, and subsequent holding demonstrates CBP’s intention to end importers’ perceived abuse of the USD800 *de minimis* provision. Importers that currently utilize the provision should review the structure of their transactions as well as commercial documentation to confirm compliance with this guidance. ■

² See [Customs Directive 3550-079A](#).

For additional information please contact:

Alexa Reed
+ 1 313 628 7976 | alexa.reed@ey.com

Lynlee Brown
+ 1 858 535 7357 | lynlee.brown@ey.com

US: Trade actions continue to be in the spotlight



Trade disputes between the US and major trading partners continue to evolve. Most recently, all four lists of punitive tariffs on Chinese origin goods under Section 301 of the Trade Act of 1974 have faced challenges; Lists 1 and 2 at the World Trade Organization (WTO) and Lists 3 and 4A in the Court of International Trade (CIT or the Court).

In addition, the US and Canada underwent a short-lived trade difference of opinion regarding Canadian origin aluminum, resulting in 15 days of punitive tariffs on Canadian aluminum imported into the US. Uncertainty also remains on trade agreement negotiations between the US and the European Union (EU), the United Kingdom (UK), Japan and other countries.

WTO panel rules in favor of China on US Section 301 duties

On 15 September 2020, the WTO released a dispute panel report detailing its conclusion regarding a case brought before the Dispute Settlement Body (DSB) by China against the US regarding Section 301 trade measures.¹

China first requested WTO consultations with the US concerning the punitive tariffs imposed by the US on Chinese origin goods under Section 301 in April 2018.² This action initiated a back and forth between the two nations for the balance of the year, culminating with China's request to establish a Panel in December 2018.³

In its complaint, China specifically challenged US List 1, which imposed 25% additional duties on products with an approximate annual trade value of USD34 billion, effective on imports as of 6 July 2018. The complaint also challenged US List 2, which placed additional duties on products with an approximate annual trade value of USD200 billion. The duties were initially imposed in September 2018 at 10%, and the US increased the rate subsequently in May 2019 to 25%. China specifically challenged that the punitive duties were inconsistent with Articles I:1 and II:1(a) and (b) of the 1994 General Agreement on Tariffs and Trade (GATT 1994), where both Articles provide for Most-Favored-Nation treatment of contracting parties, holding that countries cannot unduly increase duty rates without first meeting certain limited exceptions.

¹ See [WT/DS543/R](#).

² See [WT/DS543/1](#).

³ See [WT/DS543/7](#).

In response to China's claims, the US presented two primary arguments. First, the US asserted that as the two nations had engaged in bilateral negotiations on various trade matters, it was understood that the countries would settle disputes outside of the WTO. Further, the US contended that the punitive duties were justified under Article XX(a) of the GATT 1994 as measures necessary to protect US public morals.

Ultimately, the Panel disagreed with the US characterization of the dispute. While the Panel acknowledged the bilateral negotiations occurring between the US and China, it was determined the negotiations were occurring in parallel to the Panel proceedings, and as such, were not intended to replace the proceedings at the WTO. Further, the Panel found the Section 301 actions were *prima facie* inconsistent with Article I:1 and Article II of the GATT 1994, as the tariffs only applied to goods of Chinese origin and were applied in excess of the rates the US was bound to under Article II's Schedule of Concessions.

The Panel dismissed the US argument that punitive duties were justified under Article XX(a) of the GATT 1994 after completing a holistic review, determining the US had not met the burden of justification under Article XX(a); that is, the US had not demonstrated

how the imposition of additional duties on the certain imported products covered by List 1 and List 2 were appropriate to contribute to the public morals objective raised in the US assertion.

The US has 60 days to challenge the report. The challenge is required under WTO procedures to be in the form of an appeal filed with the Appellate Body. However, as discussed in [TradeWatch 2020 Issue 1](#), "WTO's Appellate Body disbands," the Appellate Body has become effectively defunct following the expiry of all but one judges' term and the inability of WTO member countries to reach a consensus on new appointees. As a result, the Appellate Body cannot hear cases without the requisite number of judges; therefore, even if the US were to appeal the Panel decision, the appeal would remain unaddressed until the Appellate Body became operational again.

On behalf of the US in response to the WTO's report finding, United States Trade Representative (USTR) Robert Lighthizer issued a statement criticizing the Panel's report, stating, "This Panel's report confirms what the Trump administration has been saying for four years: the WTO is completely inadequate to stop China's harmful technology practices."⁴

Lawsuit filed at CIT

The Trump administration's Section 301 tariffs on Chinese origin goods are also facing challenge domestically. A lawsuit filed September 10, 2020 in the CIT challenges the legitimacy of the Section 301 punitive duties imposed on Chinese origin goods on List 3 and List 4A.⁵

The basis of the lawsuit is that the List 3 and List 4A tariffs were not authorized as pursuant to Section

301, rather, the tariffs were imposed in response to Chinese tariff measures taken to counter US Lists 1 and 2.⁶ In other words, the actions of List 3 and List 4A were not taken to remedy the alleged unfair trade practices of China as detailed in the Section 301 report issued by the USTR, thus making the actions outside of the Section 301 scope and subsequent remedies unauthorized.

The plaintiffs⁷ in the lawsuit have asked the CIT to declare that the tariffs imposed on products covered by List 3 are unauthorized by, and contrary to, the Trade Act. Further, the plaintiffs ask that the duties collected pursuant to List 3 are refunded, with interest, and that the Court inhibit the defendants⁸ from imposing, and subsequently collecting, punitive duties on goods covered by List 3.

The lawsuit filed by the plaintiffs in Ct. Int'l Trade No. 20-177 opened the door for other importers impacted by List 3 and List 4A to challenge the tariffs. As of 18 September 2020, more than 300 cases had been filed with the Court, amounting to more than all the cases filed with the court this year. The quantity of cases filed is reflective of concern that the statute of limitations to challenge List 3 on the grounds that the actions exceeded the authority granted to the Administration by Congress expired on 21 September.

Importers are also pursuing administrative actions with US Customs and Border Protection (CBP), either in conjunction with or separately from filing lawsuits, by filing formal Protests of List 3 and 4 entries to preserve their rights to refunds should the plaintiffs win their suit. The eligible dates for protesting entries is limited to CBP's standard liquidation

⁴ See USTR Press Release, "WTO Report on US Action Against China Shows Necessity for Reform."

⁵ See Ct. Int'l Trade No. 20-177.

⁶ *Id.*

⁷ Plaintiffs in Ct. Int'l Trade No. 20-177 are HMTX Industries LLC, Halstead New England Corporation and Metroflor Corporation.

⁸ Defendants in Ct. Int'l Trade No. 20-177 are United States of America; Office of the US Trade Representative; Robert Lighthizer, US Trade Representative; U.S. Customs and Border Protection; Mark A. Morgan, U.S. Customs and Border Protection Acting Commissioner.

procedures plus 180 days; therefore, the time period for refund eligibility may be shorter, but nevertheless provide potential recovery of the subject duties in the future.

US/Canada tariffs

While Section 301 has been a primary tool used by the Trump administration to impose trade remedies, Section 232 of the Trade Expansion Act of 1962 (Section 232) has been utilized to assess duties on imports of steel and aluminum. Most recently, the US selectively employed the trade measure by levying a 10% punitive tariff on non-alloyed, unwrought aluminum articles of Canadian origin, asserting national security measures to protect domestic industry production from export surges from Canada. This action reinstated a duty originally imposed on Canadian products in June 2018, which were subsequently removed on 19 May 2019 in conjunction with adoption of the United States-Mexico-Canada Agreement (USMCA).

The reinstated punitive duties were initially imposed on 16 August 2020, following a 6 August 2020 Presidential Proclamation. The announcement noted the tariffs would apply to Harmonized Tariff Schedule (HTS) 7601.10, citing an increase of non-alloyed, unwrought aluminum from Canada that occurred in the 12 months following the May 2019 exclusions for the action, and was the result of two US domestic manufacturers request for the US to conduct the review. See *EY Global Trade Alert*, [“US imposes 10% punitive tariff on Canadian-origin aluminum; Canada announces countermeasures in response,”](#) dated 7 August 2020.



Notably, not all US producers agreed with the request nor the finding. Canada immediately followed the US decision with an announcement of intent to impose retaliatory tariffs on a range of US-origin imports containing aluminum.

The actions between the two nations were especially contentious as a key Canadian objective in USMCA negotiations was to obtain an exemption from

future use of measures under Section 232. Per a Canada-US side letter agreed to on 30 November 2018 during USMCA negotiations, the US agreed to not adopt nor maintain a measure imposing tariffs or import restrictions on goods or services from Canada under Section 232 for at least 60 days after imposition of a measure. During the 60-day period, the US and Canada would seek to

negotiate an appropriate outcome based on industry dynamics and historical trade patterns. The actions from the US were incongruent with the previously established agreement.

On 15 September, the day that Canada was scheduled to announce its conclusion and list of US items to be subject to dollar for dollar counter measures, the USTR announced the US determined it would be appropriate to remove the 10% punitive tariffs. The decision to remove the tariffs was due to the expectation of a normalization in the trade volumes of non-alloyed, unwrought aluminum for the balance of the calendar year. The USTR further advised that should imports of the subject goods exceed more than 105% of anticipated volume in any month for the remainder of the year, the US may re-elect to impose the 10% tariff. The US and Canada will hold additional consultations at the end of the year to discuss market trends for 2021.

The duty-free treatment of non-alloyed, unwrought aluminum articles would be retroactive to 1 September, per the announcement, making the re-instated tariffs applicable for a total of only 15 calendar days.

The Canadian Government subsequently suspended planned retaliatory actions on US origin. However, it is important to highlight that Canada did not agree to the US decision to apply export quotas on the subject goods, per the USTR announcement, which could result in future trade tensions between the two nations.

US trade agreement negotiations

The US also continues to negotiate trade agreements with a number of trading partners, including countries that are also subject to US actions under Section 232 and Section 301 for specified commodities.

The US and EU recently reached a limited accord around certain EU produced industrial products and US lobsters, valued at approximately USD111 million and USD160 million, respectively. While initially asserted as a first step toward a larger agreement between the US and EU, recent statements by the EU indicate an impasse regarding agricultural products will further delay a broader agreement being reached.

Additionally, the EU's large civil aircraft subsidy dispute matter remains open, with the WTO anticipated to provide findings on the Boeing case shortly. In October 2019, the WTO ruled in favor of the US, deciding the US was entitled to impose up to USD75 billion of penalties in response to the EU subsidies provided to Airbus Industries.

USTR also continues to meet with UK negotiators in anticipation of the end of the Brexit transition period, following the UK's exit from the EU, while also conducting preliminary negotiation sessions with other trading partners, such as Kenya, utilizing the approach applied to defining current US trade agreement formats such as USMCA and US-Japan. ■



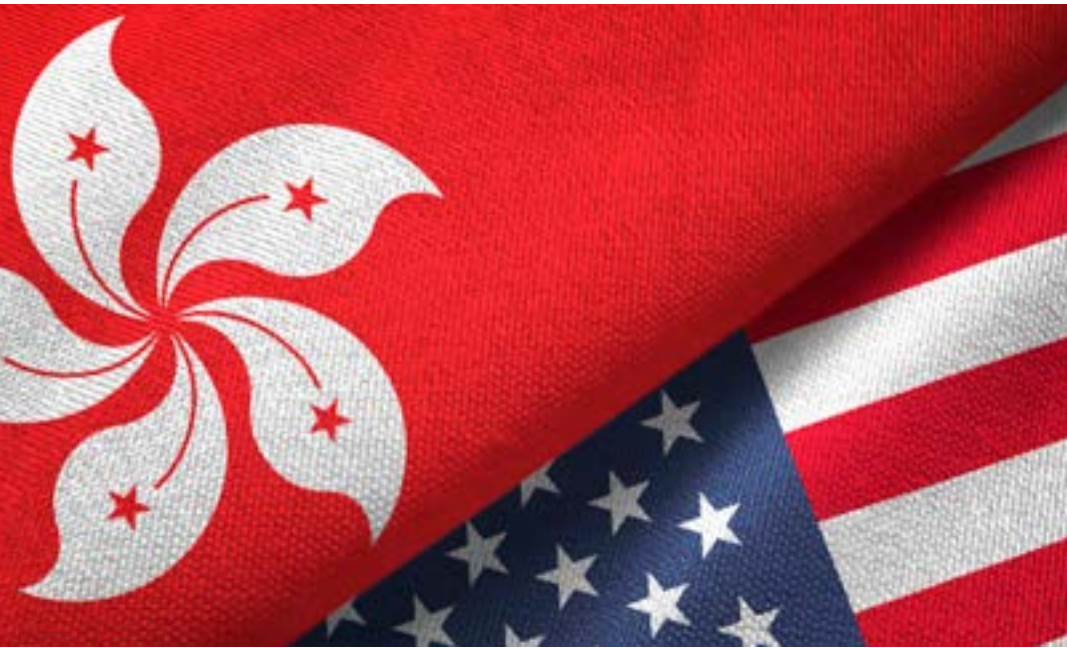
For additional information please contact:

Alexa Reed
+ 1 313 628 7976 | alexa.reed@ey.com

Lynlee Brown
+ 1 858 535 7357 | lynlee.brown@ey.com

Michael Leightman
+ 1 713 750 1335 | michael.leightman@ey.com

US: Actions toward Hong Kong give rise to additional trade complexity



The United States has taken a series of steps to restrict US economic relations with the Hong Kong special administrative region of China ('Hong Kong'). These actions suspend the special treatment that has been afforded to Hong Kong since 1997, as well as introduce a Hong Kong-related sanctions program. This policy change was made in response to several legal measures undertaken by mainland China, officially deemed by the US to undermine Hong Kong's autonomy, and accordingly, no longer warranting the special treatment bestowed on the region under US law.¹ The actions taken by the US in this area include signing of the Hong Kong Autonomy Act (HKAA),² the Hong Kong Human Rights and Democracy Act of 2019 (HKHRDA)³ and issuance of Executive Order (EO) 13936 on Hong Kong Normalization.⁴ Resulting changes from these measures include revisions to the country of origin marking requirements for products imported to the US from Hong Kong, revoking Hong Kong's preferential access to export control license exemptions cutting Hong Kong off from sensitive US technology shipments and assessing sanctions against certain Hong Kong officials. Details on these changes are described in more detail below.

Importantly, EO 13936 directs the heads of executive agencies to commence the process of eliminating all preferential treatment and policy exemptions under US law for Hong Kong, intending to treat it the same as mainland China from a regulatory control perspective. Moving forward, US business should expect continued efforts by federal executive agencies to amend regulations that bring treatment of Hong Kong in line with treatment of mainland China.

Import country of origin changes

On 11 August 2020, U.S. Customs and Border Protection (CBP) published a general notice advising that imported goods produced in Hong Kong may no longer indicate "Hong Kong" as their country of origin (COO) for marking purposes, but instead must be marked to indicate "China."⁵ "Country of origin" is where a good is wholly grown or produced, or in the case where processed in, or with inputs from, multiple countries, that country where the good was substantially transformed into a new article of commerce.⁶ Previously, items manufactured/produced in Hong Kong would be labeled as COO Hong Kong when imported to the US, due to Hong Kong's status as a separate customs territory from Mainland China and full member of the World Trade Organization (WTO).

1 See sections 205 and 301 of the United States-Hong Kong Policy Act of 1992.

2 H.R. 7440 – 116th Congress: Hong Kong Autonomy Act. [Find it here](#)

3 Hong Kong Human Rights and Democracy Act of 2019, Pub. L. No. 116-76, S. 1838, 116th Cong.

4 The EO was issued pursuant to United States-Hong Kong Policy Act of 1992 (Public Law 102-393), the Hong Kong Human Rights and Democracy Act of 2019 (Public Law 116-76), the Hong Kong Autonomy Act of 2020, signed into law 14 July 2020; the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.) (IEEPA); and the National Emergencies Act (50 U.S.C. 1601 et seq.) (NEA), among others.

5 See [85 Fed. Reg. 48,551](#).

6 See [19 C.F.R. §134.1\(b\)](#).

This new standard can present difficulties to operationalize. It requires importers to maintain a dual track of origin data for each item imported from Hong Kong, which is needed because while Hong Kong produced goods need to be physically marked with COO “China,” the customs entry declarations will continue to report Hong Kong as the country of origin. On 21 August 2020, CBP issued guidance that granted a 45-day transitional period that ended 25 September 2020 for importers to implement marking consistent with the notice.⁷ While CBP’s guidance is that this new position is limited to origin marking requirements, there is concern that this has opened the door to allow Hong Kong goods, now presumed to be of China origin for marking, to be subject to punitive tariffs under Section 301 of the Trade Act of 1974 in the future.

The Hong Kong Commerce and Economic Development Bureau has announced its intention to challenge the change of position before the WTO, citing articles 116 and 151 of the Hong Kong Basic Law that establishes Hong Kong as a separate customs territory from mainland China.⁸ Given the transitional nature of the new requirement and the potential for dispute at the WTO, US companies should continue to monitor ongoing developments on this issue.

7 See CSMS #43729326 – GUIDANCE: Additional 45-day Compliance Period for Executive Order 13936 – Hong Kong Normalization. [Find it here](#)

8 “Hong Kong’s WTO threat against US ‘Made in China’ ruling puts city in uncharted waters,” *The South China Morning Post*, Aug. 21, 2020. [Find it here](#).

9 [Find it here](#)

10 Effective June 29, 2020, BIS removed the CIV license exception for end users in Group D:1 countries that includes China, Russia and Venezuela, among others, so that a license will now be required for the export of national security (NS) controlled items, although BIS will approve a license only in exceptional circumstances. A new reason for control and the associated review policy for regional stability was created for certain items exported to China, Russia or Venezuela. See [85 Fed. Reg. 23,470](#).

11 The rule broadens EAR’s definition of “military end use,” under Section 744.21(f) that was previously confined to items incorporated into a military item or items destined for the “use,” “development” or “production,” of military items, to now include any item that “supports or contributes to the operation, installation, maintenance, repair, overhaul, refurbishing, ‘development,’ or ‘production,’ of military items.” Items now falling under this definition include materials processing, electronics, telecommunications, IT, sensors, lasers and propulsion equipment. See [15 CFR § 772.1](#).

The rule change also expands the definition of “military end users” in China to bring the definition for China in line with Russia and Venezuela, where the definition now includes “the national guard and national police, government intelligence, or reconnaissance organizations, or any person or entity whose actions are intended to support military end uses.” According to BIS, “This expansion will require increased diligence with respect to the evaluation of end users in China, particularly in view of China’s widespread civil-military integration.” See [85 Fed. Reg. 23,459](#).

12 [Find it here](#)

13 [Find it here](#)

Changes in export licensing exceptions

Historically, Hong Kong qualified for several license exceptions, found in Part 740 of the Export Administration Regulations (EAR), that allowed for the export, re-export and transfer (in-country) of items that would otherwise require an export license from the U.S. Department of Commerce’s Bureau of Industry and Security (BIS). However, on 30 June 2020, BIS published a change of practice to limit license exceptions available for Hong Kong to only those that are also available for mainland China.⁹

The unforeseen BIS export control changes relative to Hong Kong were formalized and extended in the issuance of EO 13936 on 14 July 2020. The EO further terminated export licensing suspensions previously applicable to exports of defense articles to Hong Kong persons who are physically located outside of Hong Kong and mainland China, and who were previously authorized to receive defense articles.

Importantly, the EO on Hong Kong occurred in concert with BIS rule changes for exports to mainland China: regarding the licensing of defense articles¹⁰ and notably, separate revisions made to the Military End User and End Use provision of EAR §744.21 applicable to China,¹¹ that are now also apply to exports to Hong Kong.

Suspension of defense exports

In parallel with the BIS action, the U. S. Department of State’s Directorate of Defense Trade Controls (DDTC) ended the export of US origin defense equipment to Hong Kong¹² as a means to mitigate its perceived risk that the new security measures imposed by China on Hong Kong increased the risk of sensitive US items being “illegally diverted to the Chinese People’s Liberation Army, the Ministry of State Security, North Korea or Iran.”¹³

Sanctioned activity

EO 13936 further implements, and greatly expands on, parts of the HKAA and HKHRDA, to target with economic sanctions those foreign actors which it deems to be involved in what the US government considers to be the erosion of Hong Kong’s autonomy and democratic process, and human rights in the region. The EO sets forth detailed blocking sanctions criteria for persons determined by the U.S. Secretary of the Treasury to have been involved in such conduct.

Pursuant to the EO, on 7 August 2020, the Department of the Treasury's Office of Foreign Assets Control (OFAC) imposed sanctions on 11 individuals for undermining Hong Kong's autonomy and restricting the freedom of expression or assembly of the citizens of Hong Kong.¹⁴ The individuals targeted by the sanctions include Hong Kong Chief Executive Carrie Lam, as well as other top government officials. As a result, they have since been identified on OFAC's Specially Designated Nationals and Blocked Persons (SDN) List, and all their property interests within US jurisdiction are blocked and US persons are prohibited from engaging in essentially all transactions and dealings with them. Penalties for engaging in any such prohibited transactions range from substantial civil fines to criminal prosecution.¹⁵

Actions for business

The numerous policy changes described above reflect the continued tightening of US economic relations with Hong Kong and mainland China under the auspices of national security. Businesses should consider these implications:

- ▶ Ensure global trade management systems and supply chain partners can accommodate the conflicting responsibility between origin marking and origin reporting/duty payment for goods imported from Hong Kong.

¹⁴ *Treasury Sanctions Individuals for Undermining Hong Kong's Autonomy*, Statement by Secretary Steven T. Mnuchin, Aug. 12, 2020, [Click here](#)

¹⁵ 50 U.S.C. § 1705. See also 85 Fed. Reg. 19,884. The civil penalty for violations of sanctions programs based on the International Emergency Economic Powers Act (IEEPA) is currently set at a maximum of USD307,922 or twice the amount of the underlying transaction. Criminal violations are subject to 20 years imprisonment or up to USD1 million (or both).

- ▶ US companies that have ongoing relationships with persons designated by the sanctions order would be required to immediately terminate such relationships or risk being designated themselves for providing "material support."
- ▶ Any company involved in the export, re-export or in-country transfer of items subject to the EAR should closely analyze the end-use and end-users in Hong Kong and mainland China to determine licensing requirements; and review their export controls compliance programs to help ensure they reflect these changes, including the impact on any re-exports of US-origin products and technologies.
- ▶ Given the sometime clouding of the boundary between civilian and military activities in China, compliance with the new rule on end users will require increased due diligence from US companies selling into the Chinese market cites.
- ▶ Recognize the broad and extraterritorial reach of the US export compliance regime (which can touch scenarios in Hong Kong such as foreign distribution centers as gateways for re-exports to other markets; the location of global repair and return hubs; technology collaboration involving foreign entities; and the storing of controlled technology outside the US).
- ▶ Evaluating your export compliance program to help ensure it properly monitors export control and sanctions compliance requirements. ■

For additional information please contact:

Michelle Forte
+ 1 212 773 4888 | michelle.forte@ey.com

Kian Meshkat
+ 1 313 628 7996 | kian.a.meshkat@ey.com

Justin Shields
+ 1 858 535 7237 | justin.shields@ey.com

Asia-Pacific: The changing trade landscape in the region

To say 2020 has been a tumultuous year is an understatement given the impact of the COVID-19 pandemic to the global economy, with the resultant effect on trade and to many companies' global supply chains. Trade tensions continue, with the likelihood of returning to a more benign trade environment being unlikely in the near future.

As a consequence of these major issues, companies in Australia are continuing to change their business models and are looking to reinvent their global supply chains to keep pace with the changing trade dynamics.

COVID-19 impact on global supply chains

A pandemic outbreak of this magnitude has caught companies and whole industries off guard, with a shockwave of ripple effects tearing through their supply chains and businesses. In numerous industries, demand has dropped substantially. Many industries have been required to quickly explore alternative channels (e.g., e-commerce) to sustain sales. Many enterprises have had disruptions in their logistic hubs and delivery routes due to restricted locations, closures and delays.

After decades of globalization and the consolidation of manufacturing in low-cost countries (with China a key beneficiary) major economies around the world, including Australia, are heavily dependent on global

supply chains instead of local manufacturing. There is a realization that Australia has a dependency on a concentration of suppliers that may have been too great. Having more options of alternative sourcing and setting up new manufacturing locations to address dependency could be an answer to manage global supply chain risks. Further, the benefits of a greater diversification of trading partners can also open up new export markets.

Growing trade tensions in Asia-Pacific

Adding to the needs for diversified sourcing, trade tensions and the imposition of tariffs have, particularly with targeted industries, seen a considerable impact to the landed costs of imported goods. Australia is normally an observer to world trade disruption, but more recently has been drawn deeper into the issue. One of the reported tensions is in respect of the deteriorating trade and political relationship between China and Australia.

It is evident that trade dynamics between China and Australia changed after the outbreak of COVID-19. With the Australian Government supporting an inquiry into the origin of the Coronavirus, China announced a ban on imports from four major Australian meat processing plants and introduced an 80.5% tariff on Australian barley exports. Also, China launched anti-dumping and countervailing investigations into Australian wine imports.



The official reason for these new tariffs was the conclusion of China's anti-dumping and anti-subsidy investigations, but instead is often questioned as having geopolitical roots. Before this recent tension, a free trade agreement (FTA) between China and Australia was entered into force in December 2015 and was more indicative of the positive relationship and cooperation between the countries.

Globally, challenges to policies on a wide range of subjects, including on intellectual property (IP), technology and subsidies have resulted in the imposition of tariffs between the US and both China and the EU. China and the EU have responded. Last but not least, tensions are also high between China and India. With so many of the world's leading economies in dispute, companies must react and address the risks this brings to their supply chains, especially as these disputes are unlikely to be quickly resolved.

Exploring alternative sourcing options or export markets

To shift dependency on one country, companies can investigate relocating a proportion of their manufacturing activities and sourcing options to other countries. As an option in addition to China, manufacturing locations typically include countries in Southeast Asia (e.g., Vietnam) and South Asia (e.g., India, Bangladesh). Clear winners are some of the Southeast Asian countries and India, which saw steel exports more than double between April and July to hit their highest level in at least six years. Exploring alternative sourcing countries creates the possibility to also optimize the use of FTAs as this may bring significant tariff savings.



The risk of being too heavily dependent on one country also applies to export markets, as demonstrated by the recently imposed Chinese tariffs for Australian barley exports of which typically 50% of the yearly exports goes to China (China accounts for more than 30% of Australia's total exports). As such, a diversification of the supplier base and the customer base has been a key focus of many companies, and certainly has been an issue on the C-suite agenda of many Australian companies.

Growing trade cooperation in Asia-Pacific – and beyond

Despite these times of increased trade tension, Australia in particular has continued to promote trade cooperation between countries in the Asia-Pacific region and beyond as it opens up new export markets for its main export commodities. FTAs are continuing to be promoted, with a push for companies to take full advantage of existing and mature FTAs such as the ASEAN-Australia-

New Zealand FTA, which has been in place since 2010. Other more recent FTAs, such as the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), which came into force on 30 December 2018 for Australia, Canada, Japan, Mexico, New Zealand, Singapore and on 14 January 2019 for Vietnam are providing increasing benefits to companies as each year passes.

Gradual reductions and elimination of 98% of the tariffs between signatories, with the enhanced market access this provides, has led to greater trade between CPTPP partners. The CPTPP also provides a cooperating trade bloc in the changing geopolitical landscape. With the UK showing interest in becoming a member of CPTPP, the significance of this FTA, with a geographic reach encompassing Europe, Asia and Americas would be enhanced considerably.

In September 2020, the UK agreed on an FTA with Japan, which marks its first FTA after leaving the EU. The UK has also launched negotiations for an FTA with Australia and New Zealand.

To further emphasize the positive cooperation between Asia-Pacific countries, at the Regional Comprehensive Economic Partnership (RCEP) Summit in Bangkok on 4 November 2019, 15 of the 16 countries involved in negotiations, which includes Australia, Brunei Darussalam, Cambodia, China, India, Indonesia, Japan, the Republic of Korea, Lao PDR, Malaysia, Myanmar, New Zealand, the

Philippines, Singapore, Thailand and Vietnam agreed on the chapters of the RCEP Agreement, including the market access commitments on goods, services and investment. Unfortunately, India has decided not to proceed with the RCEP FTA, but the other 15 countries are moving forward. Australia is working toward signing the RCEP Agreement during 2020.

RCEP will increase opportunities for Australian companies who will benefit from regional production chains and the common set of trade and investment rules between all signatories to the agreement. These common rules will make it easier for Australian companies to access new markets by reducing the number of different regulatory requirements businesses need to navigate when looking to trade internationally.

Combining redesigning global supply chains with FTA usage optimization

When a redesigning of supply chains is considered in order to improve supply chain resilience, this can be well combined with optimizing FTA utilization. Especially in economically challenging times, tariff savings would be an effective way to keep cost low and improve margins. In order to benefit from FTAs, companies are required to follow the rules and procedures laid down in the specific FTA, which often can be challenging.

To facilitate tariff savings, we have seen instances where Customs authorities are incentivizing companies to participate in trade facilitation programs such as the Australian Trusted Trader program where accredited companies can access “Origin Waiver” benefits on certain bi-lateral FTAs with key trading partners. The benefit eliminates the requirement to seek transactional documentation, which is required to obtain a duty free import.

The relocation of manufacturing operations may be enough to meet the relevant criteria for obtaining preferential origin benefits. As always, a good insight in the global supply chain, manufacturing operations, customs regulations, pricing and overall operations is key to identify tariff saving opportunities. (Predictive) analytics and global trade digitization in general can play a big role in this process. ■

For additional information please contact:

Richard Nutt
+ 61 2 9248 5075 | richard.nutt@au.ey.com

Adrian Ball
+ 65 6309 8787 | adrian.r.ball@sg.ey.com

Arjun Nandakumar
+ 61 3 8575 6442 | arjun.nandakumar@au.ey.com

Ruben Bel
+ 61 2 9694 5811 | ruben.bel@au.ey.com

Asia-Pacific/India: Increasing the burden of free trade agreement compliance

Across the South Asia and Asia-Pacific regions there is a comprehensive network of free trade agreements (FTAs). These FTAs provide considerable benefits to importers via preferential duty rates, often reducing most favored nation (MFN) duty rates by a considerable margin, frequently to 0%. However, those preferential duty rates come with conditions related to the “origin” criteria of goods. The FTAs will have specified origin requirements, normally in considerable detail, and the eligibility to the concessional rates prescribed under the relevant FTA depend upon the goods meeting these “origin” criteria to qualify for the preferential duty rates. There is commonly a minimal process that must be completed in the country of origin, with a required level of local/regional value content (often expressed as a percentage of the free on board (FOB) price). There may also be a requirement that there is a change in the harmonized system (HS) tariff of the component parts vis-à-vis the finished goods – known as the change of tariff heading (CTH) origin qualifying criteria. Other criteria also exist.

Increased doubt, greater scrutiny

The normal process by which importers are able to obtain the preferential duty rates is by presenting a Certificate of Origin (COO) for the imported goods. This COO will have originally been obtained by the exporter by making appropriate submissions to the COO issuing authorities in the country of export.

Increasingly, Customs authorities in the importing country have been paying much greater attention to the issue of compliance with the various FTA/COO requirements. There are numerous reasons for this, including the fact there is a perception that the COO issuing authorities have been lax in enforcing the qualifying criteria. Statistics are not readily available on the findings of COO audits by the importing Customs authorities; however, we understand that Korea Customs have a rejection rate as high as 40%. Korea Customs is one of the authorities very focused on reviewing COOs, including taking action such as conducting a review of the overseas exporters. Such a high rejection rate provides encouragement to other Customs authorities in reviewing imports that have benefited from FTAs.

One such authority is Indian Customs, which have increasingly challenged the veracity of COOs presented by importers. They are raising queries through inter-governmental channels and have also been known to conduct overseas verification visits to exporters. However, such international verifications are expensive and are, necessarily, very targeted. As such, overseas verification visits are not the broader answer to managing compliance with FTA requirements, nor will the answer come from raising additional queries through inter-governmental channels.

This may be the reason why Indian Customs have recently changed the governing legislation, Customs Act, 1962, to place much greater responsibility on the importer that avails of the FTA benefits.

Legislating greater responsibility on the importer

There has been an amendment to the Customs Act, 1962, to specifically address FTAs. A new Chapter VAA has been inserted, and this provision deals with the administration of rules of origin under trade agreement such as FTAs. Chapter VAA deals with the procedural aspects in relation to the veracity of COOs that are issued by a counterparty nation, i.e., the issuing authorities in the country of export.

In summary, these provisions aim to ensure that:

- ▶ The COO presented to Customs at the time of import is genuine.



- ▶ The importer has sufficient evidence to justify that the contents of the COO are true and correct.
- ▶ The local/regional value content declared in the COO meets the requirements of the rules of origin corresponding to the relevant FTA.

Prior to the change in legislation, submission of the COO itself was all that was required of the importer. However, Indian importers have now been made responsible to ensure compliance with the prescribed rules of origin in respect of imports that avail the FTA preferential duty rates. There is now a clear responsibility placed on the importer to exercise reasonable care and diligence in respect of claiming these FTA benefits.

Implementing the revised legislation

To effectively implement and augment the provisions of Chapter VAA of the Customs Act, 1962, the Indian Government has issued Customs (Administration of Rules of Origin under Trade Agreements) Rules, 2020 (CAROTAR 2020). CAROTAR 2020 supplements the operational certification procedures related to implementation of the rules of origin, as prescribed under the respective trade agreements.

The key highlights of CAROTAR 2020 are:

1. It came into force as of 21 September 2020.
2. Going forward, the importer shall be required to possess origin-related information to claim a preferential rate of duty. This information will need to demonstrate the manner in which the concerned country of origin criteria – the regional value content and product specific criteria – are satisfied.

3. Should the importer be requested, this information will need to be submitted to the proper officer. The importer is required to keep relevant documents for at least five years from the date of filing the Bill of Entry. This information may be requested during customs clearance or thereafter.
4. If the information received is not satisfactory, the officer can make a request to the verification authority of the exporting country to check the genuineness or authenticity of the COO. Also, non-production of documents to the satisfaction of the proper officer may lead to the importer losing out on the benefits of system facilitated clearance (meaning documents cleared without officer intervention) for future imports where FTA claim is made.
5. In case the overseas verification authority does not, upon appropriate review, provide sufficient details or confirm the origin of the goods, then Indian Customs may reject the claim of preferential FTA duty rates. An implication is that, once the concerned exporters COO is held to be ineligible for FTA benefits, future imports of identical goods could also be denied the preferential treatment, if additional verification is not provided.

Implications

This is a profound change and can create issues for many importers. As mentioned, the COO is determined by reference to qualifying criteria that can include details related to the production of said goods and the pricing that is applied. Such information in trade is usually considered as sensitive commercial information. Between related parties, the ability to share commercial information may be more

readily possible. However, transactions between unrelated companies may be impacted, particularly if the required data cannot be shared between parties inter-se. This is just one practical consideration, with many others likely to surface as implementation of the new legislation is enforced.

Next steps

In view of the above, India importers need to review their compliance and ability to avail of preferential FTA duty rates. There needs to be a clear readiness to meet the requirements, with importers having a detailed understanding of the source/origin of the manufacture goods in the context of FTA regulations. This may require having details related to the manufacture of said goods, revisiting contractual arrangements with suppliers and maintaining the necessary documentation to ensure they can access or continue to use a preferential duty rate.

If they have not done so already, importers in India should immediately inform their overseas supplier(s) about the new requirement and escalate the need to have support in compliance with the requirements of CAROTAR 2020. In case such steps are not taken on an immediate basis, many importers stand to lose the benefit of preferential tariff prescribed under the FTAs. ■

For additional information please contact:

Suresh Nair

+ 91 22 61922004 | suresh.nair@in.ey.com

Adrian Ball

+ 65 6309 8787 | adrian.r.ball@sg.ey.com

Indonesia: The changing dynamics of dealing with Customs

In dealing with customs matters in Indonesia, many companies think that they will face considerable complexity and challenges. However, as a result of reform and transformation efforts, the situation has improved considerably in recent years, although some challenges remain.

Reform and transformation

Thanks to the initiatives of bureaucratic reform and digital transformation introduced by the Minister of Finance, there have been many positive changes. Like in many other countries, the automation of Indonesia customs procedures has been a focus of reform and this has led to greater certainty in the handling of import transactions. Processes are more transparent, and the clearance of goods has been accelerated.

There have also been considerable efforts to make customs officials public-service-orientated and professional in their approach and many Indonesia Customs officials have benefitted from training programs.

Challenges still exist

However, as many companies continue to attest, although there have been improvements for business, many still face considerable challenges in dealing with customs matters in the country. Possible reasons for this include:

- ▶ Not all Indonesia Customs officials have participated in the reforms.
- ▶ Assessments are not always based on technical grounds.

- ▶ Indonesia Customs may also take positions and raise assessments that based on formal objections rather than substantive issues. For example, they may routinely reject Certificates of Origin (COO) if a box on the form has not been checked, even if all other aspects of the COO are correct and the error is not material to claiming the relevant FTA benefits.
- ▶ Officials may also face tensions between adopting technical positions that favor business and protecting government revenues.
- ▶ In many cases, Indonesia Customs may take the approach of raising an assessment and allowing the courts to determine the final position should the importer appeal. This approach is one reason why Indonesia has a high prevalence for customs issues being resolved in court proceedings.

How can importers best manage the challenges?

A first point to mention is that, when assessments are appealed and the matter is addressed in court proceedings, the majority of rulings favor importers. In practice, many Customs assessments do not withstand appropriate scrutiny. However, court proceedings may not be the best way to resolve disputes. Companies can take steps to manage these challenges more effectively. The following examples illustrate some of the key issues and approaches.

1. **Product classification.** An established Indonesia company, one with great experience of dealing with Indonesian Customs and long-established connections with department officials, was introducing a new product to the market. As a manufacturer of products that were normally



subject to excise tax, this new product was, however, different in nature.

The company decided to approach their established contacts in the Excise Division to obtain a Harmonized System (HS) classification of the new product. Used to working in the environment of dealing with products that were subject to excise tax, the officials decided that an appropriate classification was one also subject to excise tax – this being the option that resulted in a higher duty cost. This was an unexpected result and a poor outcome for the business.

Fortunately, before the ruling had been “locked,” the decision was taken to a specialist division in Indonesian Customs that addressed HS classifications. The specialist division addressed the issue through an appropriate technical approach and a classification was provided that was consistent with a broader international view of how the products should be classified.

- 2. Transfer pricing adjustments to a previously declared customs value.** Post-importation adjustments to a declared value can be made through a voluntary declaration process (VDP), but adjustments are only allowed for costs such as royalties or proceeds of resale. Transfer pricing adjustments to support that the declared value was at arm’s length are not included as allowable adjustments under the VDP.

Therefore, companies do not have a mechanism for declaring a TP adjustment to Customs, but if they do not declare said adjustment then they are commonly penalized for not doing so when

under audit. Notwithstanding that the VDP does not cover TP adjustment declarations, some companies have approached Customs to make a declaration and the current likelihood is that a penalty will be imposed, with Customs taking the approach that the importer can appeal, and the courts will rule. In similar circumstances the courts have previously ruled in favor of the importer, but there is still a risk they might not.

It is, therefore, a significant development to hear that the Indonesian Government is preparing an amendment to the VDP to include declarations that result from transfer pricing adjustments. This is a positive example of the customs administration listening to representations from the business community, leading to an understanding that TP adjustments are a normal business practice and them providing a solution to the issue.

However, the timing of the change is unclear. Until the VDP regulations are amended, it is crucial that companies that wish to be proactive in declaring a TP adjustment approach this matter carefully with Indonesia Customs to help avoid the imposition of penalties.

- 3. Accuracy of export declarations – implications with Indonesia Central Bank.** Companies have often focused more on their import declarations than on their export declarations. However, in Indonesia, the implications of export declaration errors can be considerable.

A company needed to export goods as part of an asset transfer of capital machinery. For export

declaration purposes, a value was ascribed to the goods and declared to Customs. However, in this case, there was to be no payment for the goods and thus no remittance of funds, but this was not identified in the export declaration. Expecting to see a remittance to the exporter, there were questions raised as to why that had not happened. Not satisfied by the initial response to queries, a restriction was placed on the ability for the company, and indeed all the company’s branches in Indonesia, to export goods. From such a simple omission, the implications to the business have been profound.

Exporters need to be aware of their obligations and ensure that potential pitfalls and errors are avoided.

The recent Customs reforms have created greater transparency and certainty for business. They provide opportunities for companies to engage constructively with Indonesia Customs, in ways that were not so readily available in prior years. Customs are now listening more to the business issues, as well as taking notice of international references that are relevant, when ruling on matters such as HS classifications. Companies that import into or export from Indonesia may now want to identify opportunities to improve how they manage their trade operations the light of these developments. ■

For additional information please contact:

Ary Untung Sutoto
+ 62 21 5289 5000 | ary.untung@id.ey.com

New Zealand: Transfer pricing adjustments and customs

Current business disruptions have brought in focus the age-old issue of alignment between transfer pricing and customs. As companies revisit their transfer pricing arrangements to align them with the current commercial circumstances, we explore how New Zealand has approached this complex issue and discuss recent developments.

What is the issue and why is this important?

New Zealand-based related parties who trade with members of their offshore group are required to price transactions in accordance with the arm's length principle based on New Zealand's transfer pricing rules.

Related parties are also required to declare a value for customs purposes in respect of goods that are imported into New Zealand. The primary method of valuing goods is the transaction value, being the "price paid or payable for the goods. The fact that a buyer and a seller are related should not in itself preclude an importer adopting the transaction value. However, this is contingent on ensuring that the relationship did not influence the price (i.e., the transaction occurs at arm's length).



In a common scenario, goods will be sold to a company that will act as the importer and distributor in an importing market. The distributor will have prescribed roles, risks and responsibilities and will have a target range of profitability, often expressed as a net margin percentage. To ensure that the target range of profitability can be demonstrated as arm's length, companies usually undertake benchmarking analysis against the results of similar independent companies.

The cross-border sales price will be calculated by working backward to get to the target profitability. The inherent challenge arises when, in order to achieve the target profitability, companies seek to

make a year-end tax adjustment, by adjusting the retrospective transfer price.

New Zealand approach to transfer pricing adjustments

Transfer pricing

From a transfer pricing perspective, companies are expected to demonstrate that the transfer pricing arrangements (including any adjustments) are consistent with market standards (i.e., arm's length). Inland Revenue guidance requires companies to prepare transfer pricing documentation on a contemporaneous basis that supports the arm's length nature of the actual transfer prices for that year.

In any review of such arrangements, Inland Revenue will additionally expect to see intercompany agreements between the parties that provide the ability to undertake such adjustments. In cases where companies have agreed advance pricing agreements (APAs) with Inland Revenue, Inland Revenue will expect that the conditions outlined in the APA are met while processing such adjustments.

Customs

While other countries grapple with how to deal with year-end transfer pricing adjustments from a customs perspective, New Zealand introduced a specific regime to deal with these matters as part of the Customs and Excise Act 2018.

The **provisional value regime** was introduced specifically to allow importers to make year-end adjustments, such as transfer pricing adjustments, without exposure to financial penalties.

There is limited eligibility to register for the regime, and is limited to the following situations:

- ▶ Where the importer has an APA with Inland Revenue.
- ▶ Where the value of goods is determined under the transaction value method but is subject to adjustments because of royalties and license fees or additions of proceeds due to the seller, and adjustments cannot be made because of insufficient information.
- ▶ At the Chief Executive's decision.

In doing so, the regime provides preferential treatment for those importers that have an APA with Inland Revenue.

Unless the value of goods is determined according to the transaction value method as outlined above, an importer without an APA will need to rely on a more general provision where the Chief Executive may exercise his or her discretion. Importers should be aware that before the Chief Executive exercises his or her discretion, in the event the adjustment relates to transfer pricing, the Chief Executive must consult with Inland Revenue in relation to the appropriateness of the transfer pricing arrangement.

Therefore, it is pertinent that while undertaking transfer pricing adjustments, customs considerations are kept in mind.

Why should importers enroll in the regime?

Importers could be exposed to compensatory interest if they are not enrolled in the regime and there is a change in the value of goods (e.g., as a result of transfer pricing adjustments).

Not declaring transfer pricing adjustments is a high-risk strategy because of the increased awareness of New Zealand Customs Services (NZCS) regarding transfer pricing, as well as the increased communication between Inland Revenue and NZCS. NZCS are very much on the lookout for transfer pricing adjustments as part of customs audits and will impose penalties for under declaration.

Lack of alignment creates more risk

While the provisional value regime has brought a greater convergence between transfer pricing and customs agencies, we are still seeing these issues being dealt with in silos within organizations.

Enrolling in the regime is not the end of matter, and importers need to make sure they are taking a holistic approach to these matters. Common issues that we are coming across include:

- ▶ Transfer pricing documentation does not contemplate customs agencies' impacts, or creates inadvertent customs risk
- ▶ Year-end transfer pricing adjustments do not contemplate how the adjustment will be recognized (i.e., adjustment to cost of goods sold, or other)
- ▶ Inaccuracies regarding the reporting of related party transactions
- ▶ Lack of oversight of the supply chain is creating undue risk to businesses, including broker compliance

Failure to adequately address these issues up front can be just as problematic as not enrolling in the regime.

It is worth mentioning that these issues will be magnified as a result of COVID-19. Benchmarking analysis, material assumptions in APAs and provisional customs values could be severely impacted for some companies.



What do companies need to do?

Companies need to be proactive in considering the tax as well as customs considerations while making transfer pricing adjustments.

While Inland Revenue and NZCS may apply different lenses initially to review any adjustments to existing transfer pricing arrangements, in the current environment, caution should be taken prior to finalizing any position to avoid lengthy audits later.

Despite some initial administrative bottlenecks, we believe the coordination between NZCS and Inland Revenue is intended to reduce lengthy disputes in the long run but for that to happen companies need to proactively engage with the respective authorities around their transfer pricing policies.

If you would like any further information, or guidance, in respect of the above matters please contact us directly. ■

For additional information please contact:

Paul Smith

+ 64 9 348 8409 | paul.smith@nz.ey.com

Dean Masden

+ 64 9 348 8131 | dean.madsen@nz.ey.com

Tanmoy Chakrabarti

+ 64 9 348 6650 | tanmoy.chakrabarti@nz.ey.com

Matthew Minnema

+ 64 9 348 8343 | matthew.minnema@nz.ey.com

South Korea: Revisions to Customs laws

In July 2020, the South Korean Government announced a number of tax reform proposals that include revisions to Customs laws. While the proposals have been introduced with a general aim to help taxpayers recover from damages incurred in relation to the COVID-19 pandemic, some of the proposed reforms, particularly from a customs perspective, seem to be focused more on tightening the compliance requirements with respect to import clearance procedures and customs audits.

After a public consultation process, the 2020 tax reform proposals were submitted to the National Assembly in September 2020 and are planned to become effective for fiscal years beginning on or after 1 January 2021. Overall, with harsher penalties relating to the submission of the information requested by the auditors, together with the impact of irrecoverable VAT that may result from audits, it is expected that customs audits in South Korea may become more challenging to multinational companies. This is particularly so when they face an extensive demand from the auditors for sensitive information relating to customs valuation such as details of transfer pricing and cost allocation.

In this context, it will become more critical for such companies to find ways to minimize risks in advance and to be able to explain that their transfer prices

can be considered as an acceptable dutiable value of the imported goods, e.g., through obtaining an Advance Customs Valuation Arrangement (ACVA) approval from the Customs authority in South Korea – Korea Customs Services (KCS).

This article summarizes the major changes to the Customs laws included in the 2020 tax reform proposals.

Broader grounds for VAT recoverability (Article 35 (2) of the Value-Added Tax Act (VAT Act))

In South Korea, an import VAT invoice is issued by KCS. Based on this document, the input tax can be deducted from the importer's output VAT. When the amount of import VAT needs to be changed (e.g., as a result of amending the dutiable value of the imported goods), a "corrected import VAT invoice" will be issued by KCS, and the importer will be able to use this corrected invoice for input tax deduction.



Such a corrected import VAT invoice would only be issued in limited circumstances, e.g., where it can be established that the amendment results from the importer's error of minor negligence, or a cause that is not attributable to the importer. According to the proposed revisions to the VAT Act, a corrected import VAT will be issued in broader circumstances. The table below summarizes the changes:

Table 1: Circumstances where a corrected import VAT invoice can be issued

Under the current provisions	Under the proposed revisions
<p>A corrected import VAT invoice can be issued where:</p> <p>a) The correction of the import VAT results from the importer's voluntary amendment to the customs duty without KCS's assessment or rectification</p> <p>Or</p> <p>b) The importer files amended declarations knowing that KCS would issue an assessment or rectification and it can be proven that the amendment results from the importer's error of minor negligence or a cause that is not attributable to the importer.</p>	<p>A corrected import VAT invoice can be issued where:</p> <p>a) The correction of the import VAT results from the importer's voluntary amendment to the customs duty without KCS's assessment or rectification.</p> <p>Or</p> <p>b) The importer files amended declarations knowing that KCS would issue an assessment or rectifications, except in the following cases:</p> <ul style="list-style-type: none"> ▶ Where duty payer has under-reported the customs duties by an unjustifiable means or where a penalty provision under the Customs Act is applied. ▶ Where an administrative fine is imposed for failing to submit information in respect of transactions between related parties in connection with a customs audit.

The expanded grounds for issuing a corrected import VAT invoice should mean that the importer will be able to recover the amount of import VAT resulting from voluntary amendment of customs duties in almost all cases, with few exceptions as stipulated above.

While this appears good news for taxpayers, it should be noted that for multinational entities, more caution may be needed when presenting information in a customs audit because failure to submit the information (e.g., transfer pricing policy) requested by KCS auditors in relation to related-party transactions may, in practice, incur risks of any additional import VAT resulting from amendments to customs duties being not recoverable.

The revised provision shall apply to amended declarations and rectification made after 1 January 2021.

More pressure for taxpayer to submit information relating to a transaction between related parties in customs audits (Article 30 (4), (5) and article 37-4 (6), (7) of the Customs Act)

In a customs audit, the auditors may request taxpayers engaged in related-party transactions to submit certain information relating to the determination of the declared prices of the imported goods (i.e., the transaction value or transfer price), and may nevertheless conclude that the transaction value is not acceptable for customs valuation purposes if they establish that the transaction value has been influenced by the relationship between the buyer and the seller.

With the proposed amendments, the burden of proving the acceptability of the transaction value from customs valuation perspectives has been shifted from the customs authority to the taxpayer to some extent. The proposed provision specifies that where the taxpayer is unable to present evidence for acceptability of the transaction value (i.e., that the transaction value has been determined in accordance with the normal pricing practice of the industry), the transaction value could not be used as a dutiable value of the relevant imported goods.

The amended provision also stipulates additional circumstances in which the auditors may request evidence or supporting documents to prove the acceptability of a transaction value, such as:

- ▶ Where the declared value is found to be different by more than 10% from the value based on the transaction value of identical or similar goods.
- ▶ Where the transaction value does not reflect the general expenses and profit of the seller.
- ▶ Where the transaction value has been determined in a manner different from the normal pricing practices in the relevant industry.

Customs valuation of goods imported from related parties (i.e., "transfer price") has usually been subject to intensive audit by KCS authorities over the past years, and many multinational companies operating in South Korea have difficulty in dealing with this issue. With this reform, multinational companies could be under increased pressure when presenting pricing-related information to customs auditors and so their burden in a customs audit is expected to increase further.



Strengthened measures for failure to submit information in relation to a related-party transaction as requested by KCS (Article 277(1) of the Customs Act)

Additional provisions will be introduced to impose more penalties in cases where a taxpayer engaged in a related-party transaction does not cooperate in presenting the information requested by customs auditors. Under the amended provision, a taxpayer engaged in a related-party transaction who fails to submit the requested information or submits false, unclear or incorrect information shall be subject to an administrative fine not exceeding KRW100 million. They may, subsequently, incur an additional fine of an amount up to KRW200 million if they do not present the requested information, this after imposition of the fine of KRW100 million.

The provision will be implemented from 1 January 2021 and the purpose of this revision is to further enforce submission for the information requested in relation to related-party transactions as mentioned above.

Other updates in the customs administrations in South Korea

In addition to the revisions to the customs laws, it is planned that the KCS will focus more on examining foreign exchange transactions in the forms of an investigation and audits. In particular, it is anticipated that audits on foreign exchange transactions would be carried out periodically (similar to periodic customs audits) for companies with significant values of foreign exchange transactions.

In line with the expansion on foreign exchange transactions investigations/audits, an internal restructuring within the KCS will take place toward the beginning of the next year to relocate officers to the division of investigations on foreign exchange transactions from the other divisions.

Therefore, importers and exporters are recommended to be prepared for more frequent and intensive investigations/audits on foreign exchange transactions by strictly reviewing and observing their compliance with Foreign Exchange Transactions Act (FETA) of South Korea, e.g., reporting of offset or payments made to a third-party and capital transactions. Allegations of serious violation of the FETA (e.g., price manipulation) may lead to a criminal investigation. ■

For additional information please contact:

Rachel Yeaha Hyun
+ 82 2 3787 4339 | yeaha.hyun@kr.ey.com

Vietnam: Post-clearance audit management and latest trends

The evolution of post-clearance audits

Post-clearance audits (PCA) are one of the key responsibilities of Vietnam Customs Authorities (Vietnam Customs). Not just a tool to help ensure companies' compliance with the customs regulations, PCAs also contribute to Vietnam Customs' efforts with regard to budget collection from customs duties. Based on a recent unofficial statistics paper¹ from the Academy of Finance and Hanoi State Treasury, the contribution of export duties and import duties to the total state budget is up to 15%, positioning customs duties as a key government revenue.

In 2014, Vietnam introduced an e-customs program on a nationwide basis. Generally, unless fraud was suspected, customs clearance is processed very quickly, largely due to minimal paperwork and physical checks. As such, PCAs have become more important to Vietnam, providing the opportunity to review many aspects of customs compliance post-importation. Validation of such matters as goods origin (to apply applicable free trade agreements (FTAs)), customs valuation, product classification, etc. could be done without delaying the day-to-day customs clearance of goods.

The table opposite illustrates the number of PCAs, total duties collected and duties collected per PCA from 2011 to 2019:

¹ [Find it here](#)



	2011	2012	2013	2014	2015	2016	2017	2018	2019
Number of post-clearance audits	2,016	2,564	2,430	3,412	7,561	8,311	8,987	6,320	4,673
Duties collected (USD million)	22.28	54.9	71.47	47.43	94.83	152.30	106.70	98.35	99.70
Duties collected per one audit (USD thousand)	11,053	21,417	29,410	13,902	12,541	18,326	11,872	15,561	21,334

Source: This table is combined from different articles and reports from the website of Vietnam General Department of Customs and other websites.

Based on this table, we can draw the following observations:

- ▶ There was a significant increase in the number of PCAs since 2014 compared with the earlier period.
- ▶ The amount of total duties collected from PCAs in 2016 is the highest during this period (and ever). It is quite consistent with the facts from the media that Vietnam Customs applied some strict customs treatments in 2016. For example, if the importer of record failed to check the right box of relationship between the importer and the exporter, the transaction value/declared value was rejected and a new higher value was calculated and imposed by Vietnam Customs. Some of these treatments are still under dispute, either at the level of Vietnam Customs or at court.
- ▶ The number of PCAs in 2018 and 2019 were less than that for earlier periods, but the total duties collected remained stable, and the duties collected per individual PCA was higher. It is consistent with the fact that Vietnam General Department of Customs had issued further instruction that PCAs should be carried out by focusing on high-risk areas/companies only, improving the quality of customs treatment and legal basis for that treatment and giving companies the opportunity to respond to findings before a final decision on PCA results is issued, which is done to avoid continuing disputes/appeals at a later stage.

Common PCA-related management pitfalls

Prior to applying e-customs nationwide, customs clearance would be slower as a result of Customs performing numerous checks on import and export declarations. If an error was identified at the time of import or export, assessments would be issued, and the matter resolved. PCAs were conducted but were not so prevalent. As such, once the goods were cleared for import or export by Customs, companies generally took the position that the compliance review was “completed” and they would not be subject to further assessments by Vietnam Customs.

From 2014 to now, when customs clearance is almost “automatic,” many companies have continued with the perception that clearance of the goods would be the end of Customs checks. That perception is quite incorrect, but because of it, many importers have not focused on managing their customs declarations to ensure rigorous compliance with regulations.

Using a customs broker is normal business practice, not just in Vietnam, but around the world. While the customs broker helps prepare the declaration to Customs, the importer is still responsible for the declaration and will bear all responsibilities and liabilities relating to a filing. Meanwhile, for reasons such as wanting to fast-track clearance or simply a lack of knowledge about their client’s business, the broker may incorrectly declare some content on the customs entry, which exposes the importer to potential customs risks. Many companies do not have proper processes and controls to manage their customs broker and, in Vietnam, this is an area where problems commonly occur.

The law on Customs states that the statute of limitations for PCA is five years. There is no requirement that Vietnam Customs should audit on a regular basis. Vietnam Customs have flexibility to conduct the PCA within the said statute of limitations. It is common for importers to fail to prepare for a PCA, meaning they have not identified risks or potential exposures in advance.



² Customs duty is defined as a form of “tax.”

An administrative penalty is generally 20% on additional duties collected, with late payment interest calculated at the rate of 0.03% per day on outstanding liabilities. Furthermore, the Law on Tax Administration² states that the statute of limitations for tax and duty collection is 10 years. As a result, even if customs risks are not discovered by Vietnam Customs through a PCA, companies may still be subject to customs duty collection as a result of actions by competent authorities such as the State Auditors and Government Inspectors through their routine or special tax audits and inspection activities.

Another problem area for companies is in respect of proper retention of customs-related and other transaction documentation. The Law on Customs provides that customs records must be kept for 5 years, with the Law on Accounting providing that accounting records and corresponding documents should be kept for 10 years. It is common for there to be gaps in the retention of records, which make responding to a PCA a significant challenge.

Latest PCA trends

When conducting a PCA, Vietnam Customs do not solely refer to the customs regulations, but also to other legislation. For example, they may refer to the Law on Commerce or Law on Investment to determine that a foreign invested company is not permitted to perform a specific business activity. As a result, it is common for them to reject favorable customs treatment/ duty exemption for implicated transactions.

Vietnam Customs are also increasingly cooperating with other competent authorities, with customs valuation as an example. Vietnam Customs may refer to information passed on from the tax authorities, e.g., about the domestic re-selling price of an imported product, which is then used to assess whether the declared import value of that product might be under-stated. Conversely, Vietnam Customs may also pass information about the declared import value to the tax authorities for a transfer pricing investigation.

In addition, with limited resources to conduct PCAs, companies are selected based on a risk profile and indicators of trading anomalies. Vietnam Customs have criteria regarding a risk profile or risk rating of a specific business, but such information is not public. Business should therefore pay more attention to their compliance profile, not just related to the customs area but also in other areas such as tax compliance, compliance with law on investment and even business exposure in the media. In addition, as and when there are significant changes in a company's supply chain, companies should revisit if any of these may increase their risk profile for customs purpose, or at least pose more customs issues for the business.

To encourage compliance, Vietnam Customs may also introduce enhanced regulations on voluntary disclosure. Technically, companies can currently revise their prior customs declarations (already cleared) at any time, as long as it is done before a decision on a PCA is announced. In this case, voluntary declarations, if made within 60 days from the date of customs entry, will be totally exempted from penalty, while voluntary declarations made after 60 days should still be subject to a 10% penalty. Once an audit decision is announced, voluntary declarations will not be accepted, and a penalty of 20% will be applied. We have, however, observed that in some cases Vietnam Customs is willing to consider penalty exemption even for voluntary declarations made after 60 days. We therefore envisage that a formal mechanism on penalty exemption for any voluntary declaration, as long as it is before an audit, may be considered by the regulators.

Increased digitalization and increased application of analytics are also a trend for PCAs. Vietnam is expediting implementation of a National Single Window, a portal where companies can have a place to process all required administrative procedures with different authorities at once. This system is aimed to enable effective information sharing between competent authorities for their work, fast-track procedure processing for business, etc. The customs authorities will use this portal to understand more about companies and their risk profile as part of targeting and conducting a PCA. Analytics may also be used, especially when the number of transactions covered by an audit are too numerous for customs officials to check line by line.

Typical customs issues through past PCAs

Based on our experience, there are a number of typical customs issues, as follows:

▶ Customs valuation

- ▶ Failure to include royalty payments or certain service payments in the dutiable value of imported goods, or failed to declare in time
- ▶ Failure to declare additional transfer pricing (TP) adjustment payments to their parent company in the dutiable value of imported goods
- ▶ Wrong declaration of the relationship between the importer and exporter on the customs entry, resulting in non-qualification for applying transaction value
- ▶ Failure to include some costs such as freight or insurance in the dutiable value of imported goods

▶ Product classification

- ▶ Wrong HS code being used for a product, resulting in higher duty liabilities as a different HS code was assessed by Vietnam Customs
- ▶ A specific HS code of a “finished product” being applied, rather than different HS codes being applied for different knock-down parts or materials

▶ Origin

- ▶ The Certificate of Origin (COO) was not in line with the prescribed form/template, or the authorized signature of competent authorities was not correct
- ▶ Content declared on the COO and the commercial documents was inconsistent
- ▶ There was insufficient processing or manufacturing steps in Vietnam, meaning exported goods did not qualify for Vietnam origin and the COO could not be applied for

- ▶ Failure to advance-register the list of imported machinery to form fixed assets of encouraged investment projects (e.g., projects being carried out in industrial zones), resulting in non-qualification for duty exemption
- ▶ For export manufacturing companies: weak internal controls leading to discrepancies in the inventory amount shown on accounting records vs. customs reports vs. warehousing reports, resulting in additional duty on these discrepancies as the customs authorities deem that the materials have been used in a domestic sale or consumption, rather than for re-export
- ▶ Customs procedure: selling/consuming goods before its customs entry is officially cleared by the customs authorities

Lessons learned and recommendations for PCA management and dispute resolution

First, a simple PCA normally takes about 10 working days, with up to 20 working days for a complex case. Companies have the opportunity to provide proper explanation of facts throughout the audit, but usually the Customs auditors would neither express their opinions nor disclose their proposed findings until the end of the audit. At the end of the audit, Customs auditors will issue a working-minute, recording their proposed findings. From there, a company will generally have five working days to submit their explanation to address the findings before Vietnam Customs will issue a decision and final assessment on the audit results.



Given such a tight time frame, companies will normally not have time to do all that's necessary to properly respond once a PCA is underway. Companies are therefore recommended to be prepared in advance, conducting internal audits and identifying potential problems that can be resolved, or a defense paper prepared.

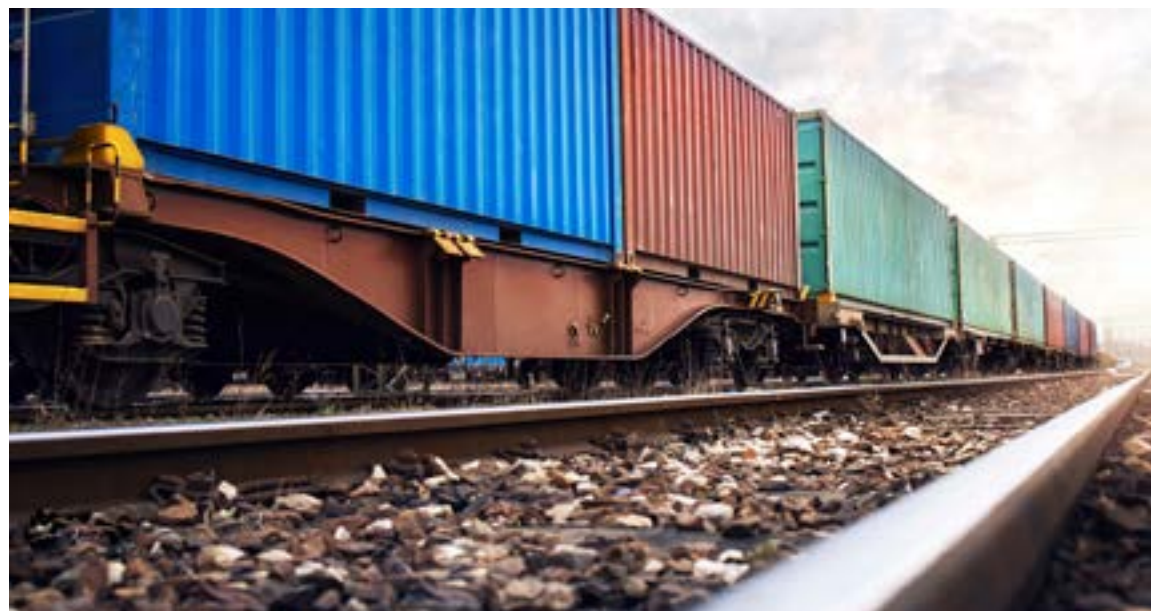
Second, to prepare for a PCA, collaboration between and among different divisions within a company will be critical. We have observed that leaving this task solely to either the accounting division or supply chain division, is not likely to be successful. Taking inventory management as an example, dealing with this matter will require multiple meetings and collaboration between accounting, supply chain and warehousing departments to reconcile various discrepancies between reports.

Third, companies need to comply with all statutory administrative procedures, protocols and deadlines throughout an audit. That will help ensure they do not lose their legal rights to escalate their case/dispute, if any, to higher competent authorities for resolution, i.e., administrative appeal or litigation. Failure to comply with deadlines may be the simplest and most common reason for a company being unable to process any further dispute and controversy resolution measures.

Finally, once a decision on the PCA outcome has been released, companies must comply with it, e.g., paying additional duties and penalties, even if they disagree with the assessment. They can then either proceed with administrative appeal procedures with Vietnam Customs or immediately bring their case to court, bypassing the administrative appeal step. Administrative appeals can be made twice, the first appeal against the customs authority who directly issued the duty assessment on the company, with the second appeal made against the higher customs authority that is the direct/immediate boss of the assessment-issuing office. Companies will have 90 days from the date of the PCA result to lodge the first appeal, with 45 days from the date of the decision on first appeal for the second appeal.

In summary

PCAs are a commonly used tool of Vietnam Customs, generating significant revenue for the government. There is increased incidence of risk-profiling and targeting of companies, with greater sharing and use of data between authorities. Audits are comprehensive, covering many trade-related issues and are conducted in a short amount of time. Response time is very limited, with preparation vital. Understanding how the audit is conducted is critical, making sure that all deadlines are met as the ability to appeal any findings will be compromised if not. Lastly, many compliance issues result from the actions of service providers, so companies need to be focused in making sure that all areas of trade compliance are addressed properly. ■



For additional information please contact:

Anh Tuan Thach
+ 84 28 3629 7366 | anh.tuan.thach@vn.ey.com

Africa: How a trade pact is positioning Africa for economic success

The recently ratified African Continental Free Trade Agreement encompasses 50 countries and is the largest free trade area in the world. Find the article on [ey.com](https://www.ey.com). ■





EU: European Commission publishes new guidance on customs valuation

On 25 September 2020, the European Commission (the Commission) published a new version of its Guidance Document on Customs Valuation (the Guidance).¹ While not legally binding, the Guidance is considered to be an important interpretation of the European Union (EU) customs legislation and it is applied by most EU customs authorities. The most important changes relate to the removal of the domestic sale principle from the guidance document and the incorporation of new examples.²

The removal of the domestic sale principle has as a consequence that a sale between two EU residing parties can be regarded as a sale for export and thus the transaction can be used as the basis to determine the customs value of imported goods in the EU if it is considered the last sale for export. In many supply chains this results in the situation that a later sale in the supply chain, which usually represents a higher value, is elected as the relevant sale for export. This may lead to an increase of import duties payable. Additionally, the new version of the Guidance introduces three new examples with regard to the treatment of royalty payments.

In this article we provide detailed background information about the introduction and removal of the domestic sale concept including how EU Member States approached the domestic sale principle before the publication of the new Guidance Document on Customs Valuation. A fragmented landscape throughout the EU is shown. We also shortly touch base on the three new examples for the

¹ European Commission, 17 Sept. 2020, Guidance Document on Customs Valuation Implementing Act Arts 128 and 136 UCC IA, and Art. 347 UCC IA, 17 Sept. 2020, TAXUD/2623395rev2/2020

² The intention to remove the domestic sale from the Guidance document on customs valuation was already announced in 2018, see our alert: [Find it here](#)

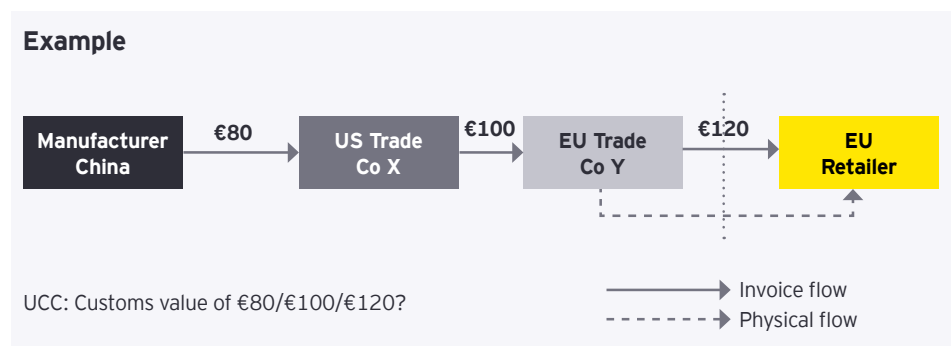
customs valuation treatment of royalty payments. The new commentaries on valuation of waste and hunting trophies, which have also been published on 25 September 2020, will not be discussed.

1. Introduction and removal of the domestic sale

The customs value is one of the three elements used to determine a customs debt in addition to the origin and classification of the imported goods. In the case of a series of sales, the relevant sale for export should be determined. In the EU, the last-sale principle applies, meaning that the relevant sale for export is the sale occurring immediately before the goods were brought into the EU customs territory.

1.1 Customs valuation under the prior Guidance Document

On 28 April 2016, the Commission published a Guidance Document on Customs Valuation.³ This legally non-binding document provided further guidelines to apply the last-sale principle and at the same time introduced the “domestic sale” principle. The Commission held that a domestic sale cannot constitute a sale for export. A transaction qualifies as “domestic sale” if the sale is concluded between two EU residing parties.



In the example above the sale occurring immediately before the introduction of the goods into the EU customs territory – the last-sale – is the sale between EU Trade Company Y and the EU Retailer (EUR120). However, this sale was, based on the old Guidance Document on Customs Valuation, to be treated as domestic

sale. Hence, this sale could not constitute a sale for export and subsequently the customs value should be based on the transaction between the US Trade Company X and EU Trade Company Y, provided of course that this transaction qualifies as a sale for export to the EU customs territory.



This same domestic sale principle applied to the situation that the goods were sold for export in a customs warehouse in the EU, where there was no sale that covered the goods on arrival into the EU. In those situations, the customs value should have been based on a transaction value of a sale “taking place in/from the custom warehouse”⁴ within the EU customs territory provided that such sale(s) do(es) not qualify as domestic sale. Following that principle, in the above example, the customs value should be based on the transaction between the Manufacturer X China and EU Trade Company Y (EUR100).

This same domestic sale principle applied to the situation that the goods were sold for export in a customs warehouse in the EU, where there was no sale that covered the goods on arrival into the EU. In those situations, the customs value should have been based on a transaction value of a sale “taking place in/from the custom warehouse” within the EU customs territory provided that such sale(s) do(es) not qualify as domestic sale. Following that principle, in the above example, the customs value should be based on the transaction between the Manufacturer X China and EU Trade Company Y (EUR100).

³ European Commission, 28 Apr. 2016, Guidance Document on Customs Valuation Implementing Act Arts 128 and 136 UCC IA, and Art. 347 UCC IA, 28 Apr. 2016, Taxud B4/ (2016) 808781 revision 2.

⁴ European Commission, 28 Apr. 2016, Guidance Document on Customs Valuation Implementing Act Arts 128 and 136 UCC IA, and Art. 347 UCC IA, 28 Apr. 2016, Taxud B4/ (2016) 808781 revision 2, page 9.



1.2 Proposal to remove the domestic sale from the Guidance Document on customs valuation

1.2.1 Background

In 2018, the Commission's Customs Expert Group (Customs Valuation Section) proposed several changes to the Guidance Document on Customs Valuation.⁵ One major change that was discussed and agreed upon was to delete all references to the so-called domestic sale principle, as well as to add more examples concerning cases where a sale between two persons, both resident in the EU, can be regarded as a sale for export.

The main reason for abolishing the concept of domestic sale is that it lacks a legal basis in EU customs legislation. The customs legislation only refers to the concept of sale for export. The wording of this regulation does not suggest that the scope of such sale should be limited only to transactions where one of the parties involved is a non-EU entity. This is also reflected in established case law of the European Court of Justice.⁶

1.2.2 Application of domestic sale in the EU: two approaches

After the intention of the removal of the domestic sale principle became public by means of the publicly available minutes of the Customs Expert Group (Valuation section), some of the EU Member States already implemented the proposed changes in their local customs practice. This resulted in problematic situations for businesses importing goods into the EU customs territory, as there was a divided landscape across the EU about whether a sale between two EU residing parties could qualify as sale for export. There are two ways how different EU Member States dealt with the domestic sale principle.

To explain the two approaches that were applied across the EU, the following example is useful. Party A (non-EU established entity) sells to Party B (EU established entity), who in turn sells the goods to Party C (EU established entity). These facts of the example are illustrated in the below graphic.



Party A (non-EU) – the manufacturer

Party B (EU) – the intermediary

Party C (EU) – the importer of the goods

⁵ During the 5th meeting of the Customs Expert Group – Valuation held on 11 and 12 October 2018, minutes published on 30 October 2018 – doc. no. taxud.e.5(2018)6229638

⁶ See for example: ECJ 6 June 1990, C-11/89 (Unifert), ECLI:EU:C:1990:237, para 13

Approach 1: Under local customs practice, the sale between two EU residing parties (domestic sale) could be used as basis to determine the customs value in the EU Member State where the goods are released for free circulation (in line with the new Guidance Document on Customs Valuation).

Depending on the applied terms of delivery and arrangements between the parties involved, the sale from Party B to Party C may constitute a sale for export to the EU. In such case, the invoice issued by Party B (invoice 2) should be used for customs valuation purposes.

A downside for businesses is that it would most likely result in an increase of customs duty (and consequently, VAT), as the invoice issued by Party B generally reflects a higher value than the invoice issued by Party A, resulting in a higher customs value and tax base of the imported goods. From a survey conducted by EY Poland it follows that this approach was applied by, among others, the following EU Member States: Austria, Belgium, Denmark, Germany, Ireland, Italy, Poland and Spain.

Approach 2: Domestic sale principle was applied, i.e., under local customs practice, the sale between two EU residing parties could not be used as basis of the customs value in the EU Member State where the goods are released for free circulation (in line with the prior Guidance Document on Customs Valuation).

Regardless of the applied terms of delivery, the sale from Party B to Party C could not constitute a sale for export to the EU, even if it occurred immediately before the goods were brought into the EU customs territory. Thus, the invoice issued by Party A (invoice 1) should be used for customs valuation purposes.

This approach resulted in a number of potential issues for the parties involved. First of all, in practice, it may not be possible for Party C to obtain the invoice issued by the Party A (invoice 1), especially if the parties involved are unrelated. This approach was applied as the default rule in the Netherlands and the UK, although both countries did allow, under specific circumstances, the price paid in the domestic sale (between Parties B and C) to be used as the basis for the customs value (i.e., under the fall-back method).

1.3 Situation under the new Guidance Document on customs valuation

1.3.1 Impact of the removal of the domestic sale

In the new Guidance Document all references to domestic sales (a concept that does not exist in the customs legislation) have been deleted. For the first example described above this would mean that the customs value should be based on the transaction between the EU Trade Company Y and EU Retailer (EUR120) provided that this transaction constitutes a sale for export. For the second example, the customs value should be determined, according to the Commission, on the sale that took place closest to the moment of the introduction of the goods into the EU customs territory. This would be the sale between Manufacturer X and EU Trade Company Y (EUR100). If the importer in this example does not have possession over the invoices relating to the relevant sale for export, the customs value should be determined on an alternative valuation method.

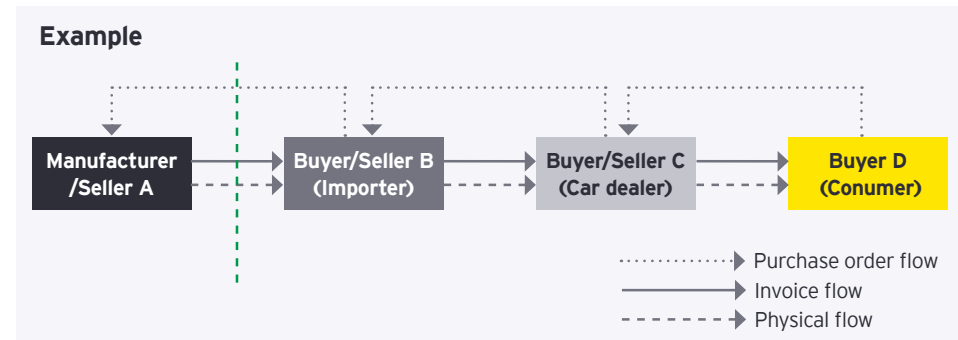
The before-mentioned examples are part of a new set of examples introduced in the new Guidance Document by the Commission. One other example that is of interest concerns example 3b. Example 3b concerns a series of sales between four parties (A-B-C-D). The sales transactions A-B and B-C take place before the physical introduction of the goods into the EU customs territory. The sales transaction B-C is considered the last-sale and forms the basis to determine the customs value of the imported goods. It is, however, party D that acts as importer in the example. This can, for instance, be the case if the goods are subject to a drop shipment at the premises of D. It can also occur that the goods are placed under a suspension regime (e.g., a customs warehouse) upon arrival of the goods in the EU customs territory and will then be sold to D. In that case the relevant sale is still the sales transaction B-C and effectively an earlier sale then forms the basis for determining the customs value if D as the importer is able to obtain the invoice of the sales transaction between B and C. If D, as the importer, does not have access to the invoice of the sales transaction B-C, the customs value should, according to the Commission, be determined on an alternative valuation method as having the invoice available is requirement for applying the transaction value method.



1.3.2 Purchase orders

Since the introduction of the Union Customs Code (UCC) on 1 May 2016, some EU customs authorities have taken the view that a purchase order (an official offer submitted to a potential buyer by a potential seller) can constitute a sale for export. In the new Guidance document, however, it is made very clear that a purchase order cannot serve as the basis for the determination of the customs value for the imported goods. Only when the future seller confirms (e.g., accepts) the purchase order, a sale agreement is deemed to be concluded between the buyer and the seller.

Example 5 of the new Guidance illustrates how the customs value should be determined in a back-to-back ordering situation.



In the above example a succession of purchase orders takes place with respect to the acquisition of a car (successively the purchase orders are issued from D to C, C to B and from B to A). The purchase order flow is followed by corresponding acceptance of such orders, which leads to a succession of sales. Irrespective of the fact that the purchase orders have been placed before the physical arrival of the goods in the EU customs territory, it is the sales transaction between A and B that constitutes the relevant sale for export as this is the last sale occurring immediately before the goods were brought into the customs territory of the Union. In other words, the customs value of the imported car is based on the sales transaction between A and B.

2. New examples on the treatment of royalty payments

The commentary of the Commission in the Guidance on the treatment of royalty payments has only been modified cosmetically. The Commission did, however, introduce three new examples about the scope of article 136(4)(C) Implementing Act UCC. This provision states that royalties and license fees are considered to be paid as a condition of sale for the imported goods if the goods cannot be sold to or purchased by the buyer without payment of the royalties or license fees. This provision is controversial as it seems to entail a catch-all provision for the inclusion of royalty payments. Although the Commission mentions that Article 136 Implementing Act UCC does not indicate an assumption that royalties and license fees are automatically includible in the customs value, the new examples do not necessarily support this view. Especially examples 1 and 2 seems to put forward that the influence and control the license holder (or a buying agent related to the license holder) has over the production line, can already constitute a condition of sale although the manufacturer is not related to the license holder or buyer. This runs contrary to our understanding of a condition of sale. It should in our view be considered whether the payment of the royalty or of the license fee is so important to the seller that, without such payment, the seller would not have concluded the sales contract.

3. Impact on business

The customs valuation position of companies is under scrutiny in the EU because of the publication of this new Guidance document on customs valuation, as well as recent case law of the European Court of Justice on the inclusion of royalty payments in the customs value of imported non-licensed semi-finished products (Curtis Balkan⁷) and the inclusion of the value of free of charge supplied software (BMW⁸).

It is recommended to evaluate your supply chain to ascertain if determining the customs value of your goods being imported in the customs territory of the EU is impacted as a result of the deletion of the domestic sale principle. Especially in the event that currently a transaction between two EU residing parties in your companies' supply chain qualifies as a "last-sale-for-export," it should be

considered whether the removal of the domestic sale principle has an impact. This could, for example, mean that going forward the customs value should be determined on a later sale within the supply chain. Accordingly, using a later sale will result in higher customs duties being payable upon import by a party subject to such duties. Additionally, it is recommendable to carefully access your companies' purchase/sales ordering process (e.g., timing of acceptance of the purchase orders) to prevent that a later sale is regarded as the relevant sale for export. Finally, the inclusion of royalty payments should, as a result of both the three new examples as well as the Curtis Balkan-case, be carefully assessed. ■



For additional information please contact:

Martijn Schippers | + 31 88 407 91 60 | martijn.schippers@nl.ey.com

Piotr Łabecki | + 48 519 098 115 | piotr.labecki@pl.ey.com

Slawomir Czajka | + 48 789 407 593 | slawomir.czajka@pl.ey.com

Marta Kolbusz-Nowak | + 48 508 018 336 | marta.kolbusz-nowak@pl.ey.com

Marcela Mrowiec | + 48 573 339 098 | marcela.mrowiec@pl.ey.com

Walter de Wit | + 31 88 407 13 90 | walter.de.wit@nl.ey.com

⁷ The EY Global Tax Alert on this court case: [Find it here](#)

⁸ The EY Global Tax Alert on this court case: [Find it here](#)

EU: Free of charge supplied software should be added to the customs value

On 10 September 2020, the European Court of Justice (ECJ) published its decision in the BMW Bayerische Motorenwerke AG v Hauptzollamt München case.¹ The ECJ ruled that the value of free of charge supplied software should be added to the customs value of imported goods irrespective of the fact that the software was developed in the European Union (EU). In this article, we elaborate about the facts and circumstances in this case, the ECJ's decision and considerations, and how this case can impact importers in similar cases in this era of digitalization.²

Facts and circumstances

BMW Bayerische Motorenwerke AG (BMW) is an automotive company established in Germany. BMW purchases control units from third-party manufacturers outside the EU. The third-party manufacturers install software on the control units that provide smooth communication of applications and systems in a vehicle and is required to execute various technical processes to be carried out by the vehicle's control unit. The software is provided by BMW to the third-party manufacturers free of charge. They also use it to perform a functionality test prior to the delivery of the control units.

In the past, the transaction value of the control units upon importation in the EU did not include the value of the free of charge-provided software. During an inspection, the German customs authorities took the view that the value of the free of charge-provided software should be added to the transaction value of

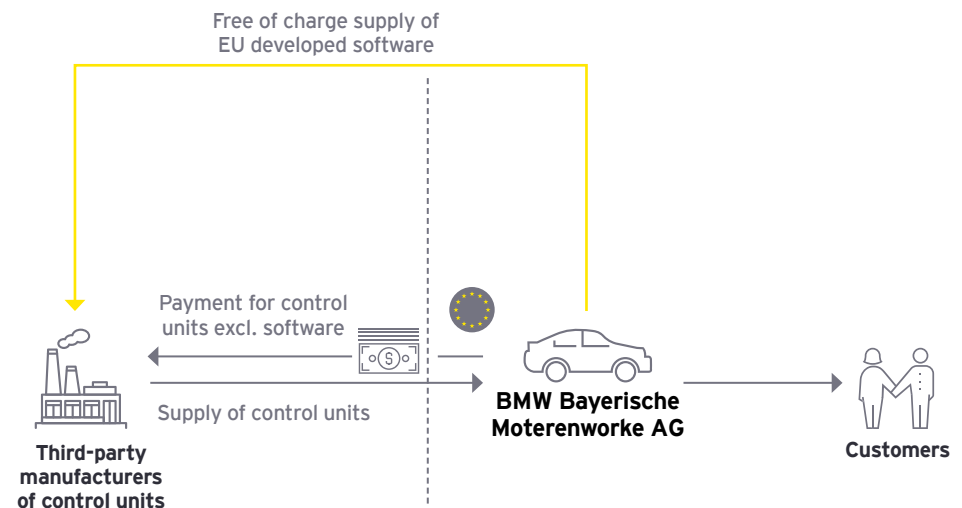
¹ ECJ 10 September 2020, C-590/19 (BMW Bayerische Motorenwerke AG v Hauptzollamt München), ECLI:EU:C:2020:694

² In an earlier edition of *TradeWatch* a contribution was included about the pending preliminary requests, see: "European Court of Justice: preliminary ruling request on customs valuation of software provides opportunity to file refund applications," *TradeWatch* 2020(1), p. 50-52



the control units for determining the customs value. In their view, the provided software constitutes a dutiable assist under article 71(1)(b) of the Union Customs Code (UCC).

The facts and circumstances are illustrated in the graphic below:



Decision and considerations of the European Court of Justice

The ECJ considers that the customs value is in principle based on the transaction value that is, in short, the invoice price settled between the buyer and seller of the imported goods into the EU. To make sure the customs value reflects the economic value of the imported goods, price elements as enumerated under article 71 UCC should be added if their conditions are fulfilled.

The ECJ considers that in the case at stake the software was provided free of charge by BMW to the seller of the control units and that the value was not included in the transaction value. Although software is not separately mentioned in the list of article 71(1)(b)(i) to (iv) UCC, this does not limit the possibility that the value of the software should be added to the transaction value of the imported control units as the wording of article 71(1)(b) refers to “goods” and “services.” It does, in other words, also include intangible assets like software.

The ECJ continues to assess whether the value should be added under article 71(1)(b)(i) or (iv) UCC. Article 71(1)(b)(i) covers “materials, components, parts and similar items incorporated into the imported goods” and cannot be interpreted as excluding intangible assets according to the ECJ. Software can, however, in the eyes of the ECJ, also qualify as an assist mentioned in article 71(1)(b)(iv) UCC which covers “engineering, development, artwork, design work, and plans and sketches.”

The distinction between article 71(1)(b)(i) and (iv) UCC is important because the value of goods and services under (iv) should only be added if the goods or services are undertaken elsewhere than in the EU. Under reference to Conclusion No 26 of the Compendium of Customs Valuation texts issued by the Customs Code Committee, the ECJ considers that the software is an integral part of the end product (i.e., control units), since they are connected to, or incorporated in them and make it possible for them to function or improve the way in which they function. Therefore, the value of the software should be added to the transaction value of the imported control units under article 71(1)(b)(i) and is it unimportant that the software was developed in the EU.

Impact on businesses

The ECJ explicitly states that the value of software should be added to the customs value as an assist provided the conditions of article 71(1)(b) UCC are fulfilled. As previously mentioned, assists as referred to in article 71(1)(b)(iv) should only be added if undertaken elsewhere than in the EU, whereas this exception does not apply to article 71(1)(b)(i) UCC. In other words, assists referred to in article 71(1)(b)(i) UCC should also be added if developed inside the EU. It is therefore, in cases that the buyer of imported goods provides in the EU developed software free of charge or at reduced cost, of utmost importance that evidence is available showing whether the software is becoming an integral part of the imported product or is necessary for the production of the imported good. As in the underlying case, the facts seem to indicate that the software is integrated, but also used and necessary in the production process, it can even be important to split the costs of the provided software to prevent to full value of free of charge supplied software should be added to the transaction value of imported goods. Furthermore, companies should especially review their provision of software to non-EU manufacturers and train their people to properly identify and correctly assess situations involving the provision of software. ■

For additional information please contact:

Martijn Schippers
+ 31 88 407 91 60 | martijn.schippers@nl.ey.com

Richard Albert
+ 49 211 9352 17756 | richard.j.albert@de.ey.com

EU: New rules for applying tariff quota in agricultural sector as of 1 January 2021



The European Commission published, on 12 June 2020, Commission Delegated Regulation (EU) 2020/760,¹ and Commission Implementing Act (EU) 2020/761,² regarding new rules for import tariff quotas subject to import licenses that will apply as of 1 January 2021. The most significant change is the introduction of the condition for several tariff quotas that operators may, in principle, only apply for tariff quotas if they are not linked with other operators applying for the same tariff quota order number. This prevents the current practice whereby several linked operators separately apply for import tariff quotas. As a result, companies may, as of 1 January 2021, benefit from a full or partial suspension of import duties for only a limited quantity of products. The introduction of this condition as well as other new features under this legislation and how these all might impact existing trade practices of companies importing agricultural products, are discussed in this article.

Tariff quotas for agricultural products

A tariff quota constitutes, during the period of validity of the measure and for a limited quantity, a total (total suspension) or partial waiver (partial suspension) of the normal duties applicable to imported goods. Tariff quotas apply for a variety of raw materials, semi-finished products and components belonging to the agricultural sector for which a deficit exists in the European Union (EU). Tariff quotas exist, for example, for horticultural products, poultry eggs, beef, pork and dairy products.

¹ Commission Delegated Regulation (EU) 2020/760 of 17 December 2019 supplementing Regulation (EU) No 1308/2013 of the European Parliament and of the Council as regards the rules for the administration of import and export tariff quotas subject to licenses and supplementing Regulation (EU) No 1306/2013 of the European Parliament and of the Council as regards the lodging of securities in the administration of tariff quotas, OJ L 185 van 12.6.2020, p. 1-23.

² Commission Implementing Regulation (EU) 2020/761 of 17 December 2019 laying down rules for the application of Regulations (EU) No 1306/2013, (EU) No 1308/2013 and (EU) No 510/2014 of the European Parliament and of the Council as regards the management system of tariff quotas with licenses, OJ L 185, 12.6.2020, p. 24-252

New requirements for operators applying for tariff quotas

Commission Delegated Act (EU) 2020/760 introduces new rules for the operators that apply for tariff quotas. First and foremost, an economic operator must be established and VAT registered within the EU.³ Additionally, the following four requirements might apply:

1. Providing proof of trade
2. Meeting the reference quantity
3. Presenting proof of origin
4. Registration in the LORI-database

1. Proof of trade

Several tariff quotas require the economic operator to provide proof of trade, in order to successfully request a tariff quota. Essentially, the economic operator must prove that a minimum quantity of products has been imported or exported, in a predetermined period before the first application may be submitted for the tariff quota period.⁴

2. Reference quantity

The reference quantity is the average amount of products that have been released for free circulation in the EU, in the 24 months prior to 2 months before the first application may be submitted for the tariff quota period. The reference quantity serves as a ceiling for economic operators, meaning that they cannot request tariff quota certificates for an amount greater than their respective reference quantity. Notably, the reference quantity is capped at 15% of the available amount under the (specific) tariff quota.⁵

³ Article 3(1) Commission Delegated Regulation (EU) 2020/760

⁴ Article 8(1) Commission Delegated Regulation (EU) 2020/760

⁵ Article 9(1) Commission Delegated Regulation (EU) 2020/760

⁶ Article 15(1) Commission Implementing Regulation (EU) 2020/761

⁷ Article 11(2) Commission Delegated Regulation (EU) 2020/760

3. Proof of origin

Several tariff quotas only apply for products from certain countries or territories. In order to substantiate the fact that goods imported under such tariff quotas genuinely originate from those countries or territories, proof of origin may be required in order to request a tariff quota certificate or to release goods, imported under a tariff quota, in free circulation.⁶

4. Registration in the LORI-database

For several tariff quotas, economic operators are required to register in the LORI-database (License Operator Registration Identification) prior to applying. The registration should be completed 2 months before the first application may be submitted for the applicable tariff quota period. If registration in the LORI-database is required, the applicant is obligated to meet the requirement for independence by either proving that:

- ▶ They are not linked with other legal or natural persons applying for the same tariff quota order number.

Or

- ▶ They are linked with other legal or natural persons applying for the same tariff quota order number but regularly perform substantial economic activities.

These requirements also apply if the import license is transferred to a transferee (e.g., the person that requires the right).

The Commission Delegated Act (EU) 2020/760 defines that an operator is linked to another legal or natural persons where:⁷

- ▶ It owns or controls another legal person.
- ▶ It has family links to another natural person.
- ▶ It has an important business relationship with another legal or natural person

If the operator has presented an incorrect document or has submitted incorrect data to substantiate that the requirements are met, sanctions may be imposed. These sanctions include the possibility to exclude the operator from the license application system for the import tariff quota concerned, for a tariff quota period following the tariff quota period during which such finding was made.

As stated above, the four primary requirements to apply for agricultural tariff follow from Commission Delegated Regulation (EU) 2020/760. In that respect, Annex II of Commission Implementing Act (EU) 2020/761 lists the existing agricultural tariff quotas with their corresponding order number and details which requirements apply for each specific tariff quota.

Impact of the new rules on companies importing agricultural products

Economic operators applying for tariff quotas that require registration in the LORI-database, will have to be mindful of the new independence requirement. In practice, linked operators (e.g., entities belonging to the same company) separately apply for tariff quotas with the purpose of benefitting from a full or partial suspension of import duties for a larger quantity of imported agricultural products. The new rules are intended to prevent linked operators from each applying for the same tariff quota order number. An exception to this rule applies to linked applicants that, if considered in isolation, each perform substantial economic activities. In this context, "substantial economic activities" means actions or activities carried out by a person with the objective to ensure production, distribution or consumption of goods and services.⁸ In practice, this means that an operator applying for a tariff quota should perform real economic activities and should not be established for the sole purpose of applying for a tariff quota.

Also, in practice it is quite common that companies establish entities with the sole purpose of applying for a tariff quota. As the before-mentioned definition of "substantial economic activities" requirement shows, this will no longer be possible under the new rules. This means that only one operator out of a group of linked operators (e.g., one entity belonging to the same company), is allowed to apply for a tariff quota. As a consequence, after the Commission Delegated Act (EU) 2020/760 becomes applicable, a full or partial suspension of import duties is only available for a limited quantity of imported agricultural products. ■



For additional information please contact:

Martijn Schippers
+ 31 88 407 91 60 | martijn.schippers@nl.ey.com

Walter de Wit
+ 31 88 407 13 90 | walter.de.wit@nl.ey.com

⁸ Article 11(3)(e) Commission Delegated Regulation (EU) 2020/760



EU: Royalty paid for know-how may need to be added to customs value

On 9 July 2020, the European Court of Justice (ECJ) published its decision in the court case named, “Curtis Balkan EOOD.”¹ The ECJ ruled that royalties paid by the buyer to its parent company for the supply of the know-how required for the manufacture of the finished products in the European Union (EU), may need to be added to the customs value of imported semi-finished products if certain conditions are fulfilled. This is in particular the case if there is a sufficiently close link between the royalties and license fees, on the one hand, and the imported semi-finished products, on the other hand. Such a link exists, for example, where the know-how supplied under the licensing agreement is necessary for the manufacture of the imported goods. This article summarizes the ECJ’s decision.

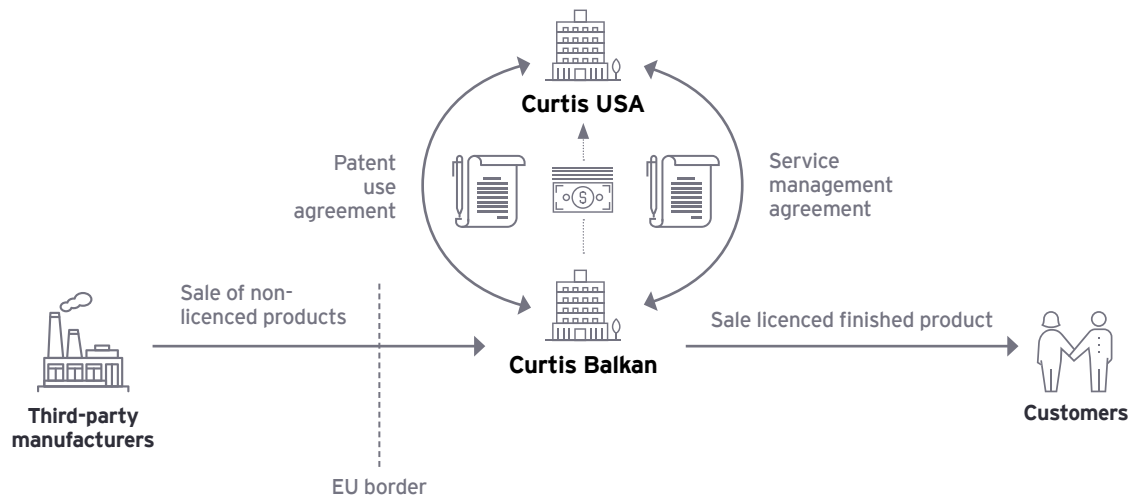
It becomes evident from this case that it is increasingly important to assess the customs valuation treatment of royalties and license fees if goods are imported into the customs territory of the EU, even if the imported goods concern semi-finished products and the royalties are paid for the manufacture of finished goods in the EU.

Facts and circumstances

Curtis Balkan, a company established in Bulgaria, is a wholly owned subsidiary of Curtis Instruments Inc. (Curtis Balkan). A Service Management Agreement and Patent Use Agreement govern the legal relationship between Curtis Balkan and Curtis USA:

¹ ECJ 9 July 2020, C-76/19 (“Curtis Balkan” EOOD), ECLI:EU:C:2020:543

- ▶ Under the Services Management Agreement, Curtis USA undertakes, inter alia, to carry out operational activities for Curtis Balkan, namely management, including marketing, advertising, preparing budgets, financial reports, information systems and human resources for an agreed monthly fee.
- ▶ Under the Patent Use Agreement, Curtis Balkan pays a fee for the right to use the patented technology that allows Curtis Balkan to produce and sell engine speed regulators and components for electric vehicles. The royalty is paid quarterly on the basis of the quarterly sales reports for the products.



For the production of the licensed finished products, Curtis Balkan purchases non-licensed components from third-party manufacturers established outside of the EU. These components are imported into the EU by Curtis Balkan and incorporated in the licensed finished products. The customs value of the imported non-licensed components is based on the agreed sales price between the third-party manufacturer and Curtis Balkan. The Bulgarian customs authorities were of the position that the royalties paid by Curtis Balkan to Curtis USA should be added to the customs value. In appeal, the Varhoven administrativen sad (Supreme Administrative Court, Bulgaria) asked for a preliminary ruling and brought 11 questions before the ECJ about the customs valuation treatment of the royalty payments. In essence, the question is whether a proportion of the royalties paid by Curtis Balkan to Curtis USA in consideration for the supply of know-how for the manufacture of finished products in the EU must be added to the customs value of the imported semi-finished products that will be incorporated in the finished products?



Decision of the ECJ

The ECJ emphasizes that in principle the customs value is based on the transaction value of the imported goods. The transaction value is the price paid or payable for the goods sold for export to the customs territory of the EU. To make sure the transaction value reflects the real economic value of the imported goods, the price paid or payable should be adjusted by adding certain price elements, such as assists, royalties and license fees and proceeds. In this particular case, the ECJ considered that the fee paid by Curtis Balkan to Curtis USA in return for the supply by Curtis USA of know-how for the purpose of the manufacture of the products in which the imported goods were incorporated, fall within the concept of "royalties and license fees." The ECJ stresses that royalties and license fees should only be added if three cumulative conditions are satisfied, namely that:

1. The royalties or license fees have not been included in the price actually paid or payable.
2. The royalties or license fees are related to the goods being valued.
3. The buyer is required to pay those royalties or license fees as a condition of sale of the goods being valued.

Condition 1 – The royalties or license fees have not been included in the price actually paid or payable.

The first condition is fulfilled because the license fee paid by Curtis Balkan has not been included in the customs value of the imported components.

It is for the referring court to determine if the second and third condition are fulfilled, although the ECJ does provide further guidance how these conditions should be interpreted. This guidance is discussed in greater detail below.

Condition 2 – The royalties or license fees are related to the imported goods.

The ECJ considers that where the imported goods are merely a component of goods manufactured in the EU, an adjustment to the price actually paid or payable for the imported semi-finished products is only to be made when the royalty relates to those semi-finished products. The method of calculation can, in that respect, be indicative, however, is not in itself conclusive. There must be –

and this is generally a new criterium introduced by the ECJ – *a sufficiently close link* between the royalties or license fees, on the one hand, and the imported semi-finished products, on the other hand. The ECJ indicates that such a link exists where the know-how supplied under the licensing agreement is necessary for the manufacture of the imported goods. That is indicative of the fact that the semi-finished products were specifically designed for incorporation into the licensed product without any other reasonable use being envisaged. An indication that a sufficiently close link does not exist, can be derived from the fact that know-how is necessary only for the completion of the licensed goods.² According to the ECJ, it is up to the referring court to decide if such a sufficiently close link exists. In that regard, all relevant factors, in particular the relationships of law and of fact between the persons involved, should be examined.

Condition 3 – The buyer is required to pay those royalties or license fees as a condition of sale of the goods being valued.

The ECJ explains that the "condition of sale test" comes down to the question of whether in the course of the contractual relations between the seller, or a person related to the seller, and the buyer, the payment of the royalty or of the license fee is so important to the seller that, without such payment, the seller would not have concluded the sales contract. In circumstances in which the seller of the goods being valued is separate from the licensor, it is ultimately necessary to know whether the person related to the seller is capable of ensuring that the imports of goods are subject to the payment to him or her of the royalties or license fees in question. In other words, is that person legally or operationally in a position to exercise restraint or direction over the seller. This should be tested with respect to the relationship between Curtis USA and the third-party manufacturers of the imported semi-finished products by the referring court.

It is questionable how the ECJ's explanation of the condition of sale test in the present case relates to the ECJ's ruling in the GE Healthcare case.³ In that case, the ECJ held that:

² The latter is in line with the view the Technical Committee on Customs Valuation of the World Customs Organization expressed in Advisory Opinion 4.9. Royalties and licence fees under Article 8.1 (c) of the Agreement. (Royalty that the importer is required to pay to a seller (the trademark holder) for the right to manufacture, use and sell the "licensed preparation" in the country of importation and for the right and licence to use the trademark in connection with the manufacture and sale of licensed preparations in the country of importation) (Adopted, 26th Session, 8 October 1993, 38.480).

³ ECJ 9 March 2017, [C-173/15 \(GE Healthcare GmbH\)](#), ECLI:EU:C:2017:195.

“... royalties or licence fees are a ‘condition of sale’ of the goods being valued where, within a single group of undertakings, those royalties or licence fees are required to be paid by an undertaking related to both the seller and the buyer and were paid to that same undertaking.”

One may argue that this consideration of the ECJ means that the condition of sale test, within a single group of undertakings, is automatically fulfilled (deemed condition of sale). The present case, however, seems to nuance this view. To determine whether the condition of sale test is fulfilled, the decisive question is always, in the light of all the relevant factors, whether the supply of the goods would have taken place if the royalty payment has not been made.

Union Customs Code

Although this court case is decided under the Community Customs Code (CCC), this case seems to be even more important under the Union Customs Code (UCC), which governs the customs valuation rules in the EU as of 1 May 2016. The UCC introduced more stringent rules for royalties and license fees. These rules on royalties seem to have increased the taxable scope, as under the UCC, royalties and license fees are included sooner in the customs value than under the CCC. For instance, in a scenario whereby the buyer, the seller and the licensor are all unrelated, a royalty or a license fee may still need to be part of the customs value as “a license holder” can also impose a condition of sale. Moreover, the rule focuses on the obligations of the buyer, rather than the requirements of the seller. Put differently, a licensor in many cases cannot block a (non-affiliated) seller from selling the product to a buyer (even if affiliated to the licensor), but it can block the purchase of the product if the royalty is not paid by the buyer (certainly when the buyer is affiliated to the licensor). Consequently, the royalty would become dutiable in many more situations than under the current legislation. Turning back to the Curtis Balkan case, the decisive question, according to the ECJ, to determine whether a royalty is paid as a condition of sale is whether the supply of the goods would have taken place if the royalty payment has not been made. This question seems to be answered sooner in the affirmative under the UCC compared to similar facts under the CCC because of the more stringent rules for royalties and license fees explained above.

⁴ Request for a preliminary ruling of 22 November 2019, C-775/19 (5th AVENUE Products Trading) and request for a preliminary ruling of 13 February 2020, C-75/20 (“Lifosa” AB v Muitinės departamentas prie Lietuvos Respublikos finansų ministerijos).

Customs valuation under scrutiny

It follows from this ruling that it becomes increasingly important to assess the customs valuation treatment of royalties and license fees, even if the imported goods concern semi-finished products and the royalties are paid for the manufacture of finished goods in the EU. Put differently, the customs valuation position of importers comes, as a result of this ruling, under increased scrutiny. Also, this ruling cannot be seen in isolation, because the ECJ recently issued a court case about the dutiability of assists in the *BMW Bayerische Motorenwerke AG* case, which is also discussed in this issue of *TradeWatch*. Additionally, there are two pending ECJ cases about customs valuation being the 5th AVENUE Products Trading case about distribution rights and the “Lifosa” AB v Muitinės departamentas prie Lietuvos Respublikos finansų ministerijos case about transport costs.⁴ Finally, a new version of the Guidance document on customs valuation of the European Commission has recently been issued, as also discussed in this issue of *TradeWatch* (page 44), with the major difference being the removal of the domestic sale. ■



For additional information please contact:

Martijn Schippers
+ 31 88 407 91 60 | martijn.schippers@nl.ey.com

Walter de Wit
+ 31 88 407 13 90 | walter.de.wit@nl.ey.com

Export controls: Sanction lists and data protection

Adherence to export control and foreign trade regulations can mean that the General Data Protection Regulation (GDPR) requirements have to be observed. This is not as simple as it sounds, as companies need to have a holistic and overarching compliance approach if they want to avoid severe fines.

If different statutory regulatory areas have contrasting regulatory objectives, a company may find itself facing an apparently irresolvable conflict of interests, practically forcing it to violate laws. Such a clash will be encountered when checking sanction lists originating from export controls while at the same time following data protection requirements. There are no guidelines from the authorities as to how to bring the two regulations in line. Nevertheless, companies face severe fines if they, for example, do not comply with applicable US sanction lists or the EU GDPR. However, because checking sanction lists is usually an automated, standard process, it is very important for companies to be well positioned in this area. They need an overarching compliance approach that considers the various requirements in a tailored, legal and practical way.

Sanction lists

Sanction lists are records of people, companies, organizations or institutions (subsequently referred to as “parties”) that are subject to economic and legal restrictions by governments or authorities. These are often related to security and foreign policy objectives, combating terrorism and organized crime or increasingly also to enforce human rights. The parties designated by the EU and the US are not identical.



Difficult to check

Companies are prohibited to do business with parties designated on a sanction list. At the same time, some sanction lists only restrict transactions in specific sectors or with certain items. From an operational perspective, there are a number of challenges when checking sanction lists, for example:

- ▶ Company-wide risk analysis for the area of sanctions compliance
- ▶ Identifying the lists relevant for the company
- ▶ Dealing with foreign lists (such as US lists from various authorities) while, at the same time, observing national antiboycott regulations
- ▶ Continuous changes and updates of designations
- ▶ Setting up search algorithms and hit probabilities when using compliance software
- ▶ Different ways of spelling business partner's/customer's names and addresses
- ▶ Large data volume and lack of sufficient resources for verifying hits
- ▶ Sufficient monitoring in case of outsourcing of checks
- ▶ Proper documentation and archiving of findings
- ▶ Developing risk-based approaches for checking sanction lists considering the special features of digital business models

- ▶ Developing risk-based approaches for identifying designated owners of business partners (indirect prohibition on provision to these parties)
- ▶ Design of operative assistance tools for the handling of identified matches (e.g., checklists, workflows, escalation steps)
- ▶ Design of sufficient interfaces between the department who is conducting sanction list screening operationally and other departments and functions
- ▶ Involving foreign majority ownerships in a corporate-wide sanctions compliance program (regulatory requirements vs. best practice approaches)
- ▶ Education and trainings, which fulfill the requirements of operations in addition to increasing the understanding of regulatory requirements
- ▶ Regular system and effectiveness audits of the internal sanctions compliance program, which might be part of the internal export control program, including the testing of automated solutions used for sanction lists checks

Companies must not underestimate the importance of adherence to sanction lists. In particular, the US administration regularly imposes severe fines on companies that do business with sanctioned parties. Even a minor connection with the US can be sufficient to establish a US jurisdiction in this sphere, and in the case of US secondary sanctions, the US administration does not even need a US nexus for their applicability. While such wide applicability of extraterritorial sanctions might be debatable under international law, from a practical perspective, companies need to carry out a risk analysis and base their decision after weighing the respective risks for their business.

European data protection

When checking sanction lists, companies have to compare data of customers or other business partners with the respective lists. Since this involves processing personal data, the GDPR applies in EU Member States. This generally requires a legal basis for each piece of personal data that is processed. The legal basis for checking sanction lists can be a “legal obligation” (Art. 6 (1) c GDPR) or is based on “legitimate interests” pursued by the controller (Art. 6 (1) f GDPR). European sanction lists – in the form of EU anti-terrorism and embargo regulations as secondary community law – represent a legal obligation for European companies.

Lists from third-party countries

By contrast, sanction lists from third-party countries, such as the various US sanction programs, do not qualify as a legal obligation as defined by the GDPR. However, checking against these lists may represent a legitimate interest because if European companies do not observe and comply with US sanction lists, they are in fact risking fines and a loss of reputation on the US market. The problem here is that the interests of the company have to be balanced against the interests of the party as a data subject and is not automatically guaranteed.

What is “necessary” from a data protection perspective?

In both cases – whether the legal basis now exists in the form of a legal obligation or a legitimate interest – the GDPR also stipulates that the processing of data has to be necessary to fulfill a purpose. Determining whether this is the case is also tricky. For one thing, the Federal Finance Court in Germany (BFH) decided in a ruling from 2012 in connection with obtaining the status of “authorized economic operator” under foreign trade law that checking employee data against the EU terrorism lists is permissible and necessary data processing in the contractual employment relationship, Sec. 32 BDSG [“Bundesdatenschutzgesetz”: German Federal Data Protection Act] old version (now: Art. 88 GDPR in conjunction with Sec. 26 BDSG). However, checking against sanction lists often cannot currently take the “performance of a contract” as a legal basis (Art. 6 (1) b GDPR). This is because the guidelines by the European Data Protection Board (EDPB) state that the legal basis of performing a contract must be “interpreted restrictively.” For instance, the EDPB does not consider processing to prevent fraud to fall under this legal basis and refers to the aforementioned legal bases in Art. 6 GDPR.

Operating requirements of the GDPR

According to the principle of *data minimization*, personal data may only be collected or used to the extent required for checking against the respective sanction lists. The parties as data subjects *must be informed about the particular data processing* in advance and, if the check is based on "legitimate interest," informed about their potential right to object this. Furthermore, companies are required to ensure suitable, appropriate *technical and organizational measures* to protect (the integrity and confidentiality of) the data used. Findings and comparison data may only be kept for as long as a corresponding deletion concept deems necessary for the purpose of processing. Then, companies have to document the data processing relating to checking against sanction lists and carry out a data protection impact assessment. Finally, they must be in a position to demonstrate compliance with these requirements, even to a supervisory authority (accountability principle according to Art. 5 (2) GDPR).

Fines

This is why companies should not underestimate the importance of data protection. The German regulatory authorities can respond to infringements with fines of up to 4% of the worldwide annual turnover of a company. For instance, the Berlin Data Protection Authority imposed a fine of EUR14.5 million on a real estate group for not having/having an unreliable deletion process for dealing with the personal data of tenants. And the Federal Commissioner for Data Protection imposed a fine of EUR9.55 million on a German telecommunications and internet provider; the reason here: insufficient technical and organizational measures to process customer requests. Also, the Data Protection Authority of Baden-Wuerttemberg issued a fine in the amount of EUR1.24 million against a regional health insurance organization for insufficient technical and organizational measures to ensure information security while processing personal data of customers for additional marketing purposes.

At the same time, the compliance requirements of export control law must also be met. The introduction of automated solutions through the selection of suitable sanctions list screening software tailored to the needs of the respective company (there are various providers on the market) is a first, important step as part of a comprehensive internal sanctions compliance program. Risk analysis, internal framework, training and internal audits are other key elements of the internal compliance program, which must also take into account the data protection aspects set out above. ■



For additional information please contact:

Rafik Ahmad
+ 49 6196 996 22586 | rafik.ahmad@de.ey.com

Daniel Kaiser
+ 49 89 14331 13001 | daniel.kaiser@de.ey.com

Eric Meyer
+ 49 89 14331 11243 | eric.meyer@de.ey.com

What multiple waves of disruption mean for tax and trade in Europe



The tax and trade landscape was on the brink of massive change at the start of 2020. Then came the COVID-19 pandemic with a new layer of disruption. Chris Sanger, EY Global Government and Risk Tax Leader and UK Tax Policy Leader, Sally Jones, EY UK Trade Policy Leader, and Douglas Bell, EY Global Trade Policy Leader, examine the current tax and trade environment and explore potential developments for the future. Find the article on [ey.com](https://www.ey.com). ■

Technology



How trade systems and managed services can reduce the burden of complexity

Technology

As we head toward the end of the Brexit transition period, we are in a position similar to where we were with previous Brexit deadlines; no deal has been agreed, there are no firm details on Northern Ireland movements and the requirement for full customs declarations for goods moving between the UK and the EU is just around the corner. However, a critical difference is there is certainty that it will happen and when.

As it stands, the chance of a deal between the UK and EU remains but, is becoming increasingly unlikely – with “no-deal,” as before, being the scenario, most businesses are planning for. With that said there are still many businesses that have not yet fully prepared for Brexit, with some having the mistaken belief that a deal will eventuate requiring no customs formalities at all.

Regardless of a deal, full customs declarations will be required after the transition period is over on 1 January 2021. A deal would potentially create even more complexity, as an origin management program would then be needed to ensure the agreement was fully leveraged. This means that no matter the negotiations between the UK and the EU, businesses need to be ready with full and accurate master data to allow for customs declarations. This also includes preparing interfaces to broker systems, evaluating and applying for customs special procedures and ensuring they have all the required documents and regulatory requirements in place within a matter of weeks.

This is not just a challenge for business, but with customs authorities of both the UK and the Member States of the EU developing systems and training staff to be ready for transactional volume they will face at the end of the transition period. The UK tax authority (HMRC) has been shoring up its aging customs declaration system, Customs Handling of Import and Export Freight (CHIEF), to be ready for the massive increase in declarations while simultaneously readying their successor system, Customs Declaration Service (CDS), to take over at an undetermined point. At the same time a new system, TSS (Trader Support Service), is under development to help businesses trading with Northern Ireland. On the continent there are new systems being developed as well, including the Smart Border system in France and NxtPort in Belgium. All these new systems add to the complexity and risk as they go-live and businesses and brokers need to find ways to work with them.

When it comes to customs data feeding into these systems the way most businesses currently report on movements between Member States of the EU is through Intrastat submissions. This process will continue following the transition even within the UK. This data includes commodity codes, incoterms, values, weights and some limited other fields. However, this data is insufficient to complete a customs declaration. For example, after Brexit businesses will need 10-digit classifications rather than the 8-digit codes currently used on Intrastat. Additionally, the value of goods declared in a customs declaration is not simply the invoice value but is a customs value calculated to include elements such as insurance and freight, among others. The area of valuation is one customs

authorities are increasingly focusing on, regardless of Brexit, due to the impact this field has on duties.

Generally, Intrastat data can be subject to accuracy issues, increasing the level of risk. Many businesses have submitted goods incorrectly classified, incorrect values, weights and incoterms. These will all need to be reviewed and corrected to ensure correct customs declarations are made after Brexit.

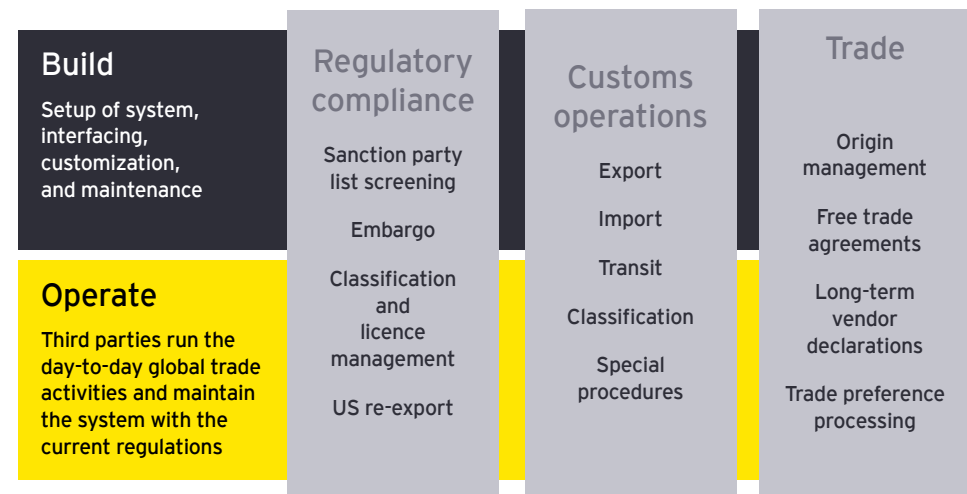
Mitigating the cost of Brexit itself is another key priority for businesses that creates additional complexity in developing processes to run these mitigations. Under a no-deal scenario, options such as inward and outward processing, customs warehousing and other special procedures become of even greater benefit. In addition, and as alluded to earlier, an FTA creates additional complexity in the management of long-term supplier declaration and origin calculations.



With all this process and data change comes significant resource requirements, and with a limited talent pool of customs specialists, this is creating significant demand and opportunity for trade systems and managed services to help businesses manage this challenge.

Trade automation systems have been in use by many businesses for years, with the automotive sector as an example, widely using solutions. These systems typically allow for the automation of many of the processes and procedures raised above, including customs filing, trade compliance, inward processing management and preferential determination. They broadly work by interfacing directly with either brokers or in some countries the customs systems of the authorities themselves while also connecting to the company's master and transactional data. When an order is created, the system can automatically review the company's customer or supplier against sanctions lists to help ensure compliance with export controls. When classifications are assigned, they can check to confirm these are valid for goods and then as goods are imported, they can automatically file customs declarations using a customs' filing module.

Automation and managed services



When it comes to preference management, these systems can identify when a business needs long-term supplier declarations to effect bills of material for preference calculations. With these acquired, the systems can then make the complex calculations using rules of origin data within the system to evidence to authorities that the goods meet the relevant agreement. Similarly, for inward processing and customs warehousing these systems make these procedures manageable while helping to ensure compliance.

Other solutions such as machine learning and AI classification for customs classification are becoming increasingly in demand. These systems allow for automatic classification of a significant proportion of goods, reducing the demand for manual classification, which can be resource intensive for some businesses.

Despite these various systems significantly reducing the workload of customs procedures, they do not completely remove the need for trained customs professionals to use these systems. Businesses will need to resource accordingly to run and manage them and will also need significant involvement from their IT resources to implement the systems themselves, unless they decide to outsource the implementation to a third party. In addition, there is a significant capital and operational cost to implement these systems and sustainably manage them year in year out. Updates and changes will need to be made over time, which may result in additional resource and financial costs.

Managed services are now rising to the fore as a solution to these resource costs and upfront capital expenditures. With a managed service, the service provider can make use of systems, such as those described above, at the additional benefit to the businesses that they have already made the capital investment to use them. They will also already have the resources available to run the systems themselves reducing the need for a business to hire, train and retain swathes of customs professionals. This enables a business that needs resource to manage preference, customs filing, trade compliance or other customs functions, to make use of a managed service and only pay for what they need and use, allowing for rapid scale up and scale down as required.

For example, a business looking to make use of inward processing in the UK would, following approval for the procedure, simply allow a managed service provider to access their master data and import data to manage the special procedure for them with minimal involvement from their side. This would result in minimal setup time, quick actualization of savings while maintaining compliance with customs authorities.

Despite all the above, not all businesses will need to make use of these systems. Many businesses, particularly smaller, less complex ones, will manage Brexit effectively with written processes, standard software and a good broker. However, understanding the impact, assessing the mitigation options and evaluating whether the business has the resources to manage with the people and systems the company has, is just one of the essential steps to making Brexit as painless as possible.

Without a doubt, Brexit and the 1 January 2021 end of the transition period are going to pose one of the largest challenges to businesses in recent times, in addition to the recent pandemic and the way COVID-19 has shaped current operations across all industries. The complexity of customs cannot be underestimated, but at the same time this creates opportunities for smart businesses to get their data and systems ready, implement mitigations and get ahead of their competition. ■

For additional information please contact:

Tobias Pospischil
+ 44 20 7783 0696 | TPospischil@uk.ey.com

Keshia Wagner
+ 33 1 55 61 15 29 | keshia.wagner@ey-avocats.com

Nicolas Khedir
+ 32 2 774 6162 | nicolas.khedir@be.ey.com

Brexit



Brexit

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Brexit: 100 days to go

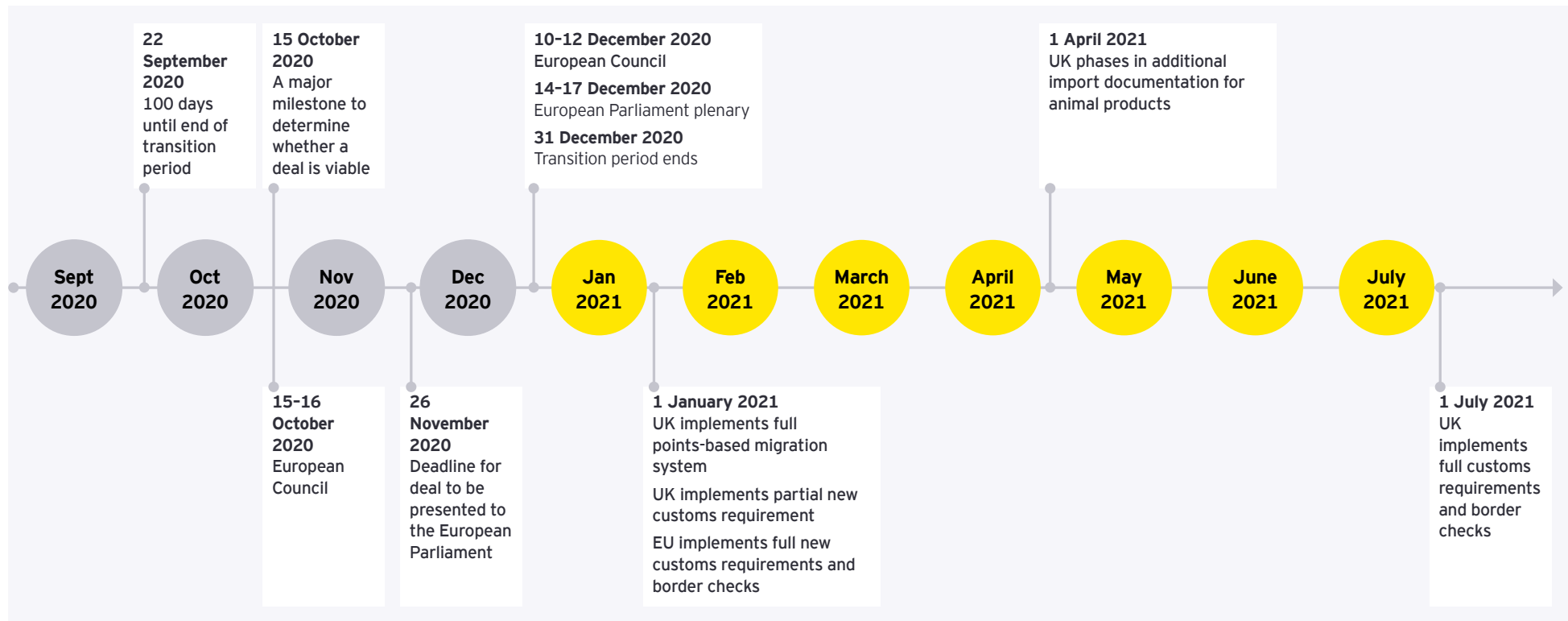
22 September 2020 marked 100 days until the end of the Brexit transition period. When the transition period ends (31 December 2020), the UK will leave the EU's Single Market and Customs Union. It will then begin a new economic relationship with the EU – either with a trade deal or without. For business planning purposes:

- ▶ The limitations on the scope of any free trade agreement (FTA) are known. The published UK and EU draft texts set clear boundaries for the scope of what can, and crucially what can't, be achieved through negotiations.
- ▶ “No deal” would mean the UK reverting to World Trade Organization (WTO) terms. The implications of this outcome are mostly known.

The path to December 2020

UK and EU negotiators continue to seek agreement on the future relationship. If the teams are able to agree on a deal in principle, then it will need to undergo the necessary decision-making processes on both sides – including the European Council and European Parliament – in order for the agreement to be ratified and enter into force in time for 1 January 2021. Some form of implementation period may well be included within the drafting.

Against this backdrop, the UK is also in the process of trying to roll over its remaining “continuity” trade agreements to lock in the benefits it currently enjoys from the EU's FTAs with third countries, as well as launching new trade negotiations with the US, Australia and New Zealand.



What impacted organizations should be doing in the time remaining

With this in mind, we identify four key questions businesses should be using as a framework for preparations in the time remaining:

1. What do we need to do now to continue operating after 31 December 2020?

With political noise increasing, businesses cannot afford to wait for final certainty on the outcome of the UK/EU negotiations. Their focus should turn to practical, commercial, no-regret solutions that help to mitigate negative impacts of change.

2. Are any existing Brexit plans still fit for purpose?

The COVID-19 pandemic, together with the removal of earlier published easements, means that preparing for Brexit now feels significantly different than for previous Brexit deadlines.

3. What actions can still be taken in the time remaining?

The lead time for implementing many mitigating strategies has passed, with other deadlines rapidly approaching therefore relevant actions must be taken urgently.

4. What should we be considering now for 2021?

To fully take advantage of the new trading environment that will result after the transition period, successful businesses will likely need to reassess their wider operating and trade models including supply chain, provision of services, workforce strategy and data.

Key impact areas for consideration

Changes from the end of the transition period will impact all business functions – we have categorized these into:

▶ Trade in goods and customs

As a result of the UK leaving the EU Customs Union, there will be additional customs formalities and checks. This change will have an impact on all goods coming into the UK – not just from the EU – but most particularly goods entering the EU from the UK. This is because the EU is implementing full border formalities from 1 January 2021, whereas the UK is phasing in its formalities over six months. Applicable customs duties on trade from third countries into the UK will also change, in line with the UK Global Tariff.

▶ Supply chain

Brexit may lead to delays at the border. Businesses that were previously straightforward distributors or suppliers will become the importer and exporter of record for customs purposes, and the EU importer for product safety purposes. This comes with many additional regulatory and legal obligations. As a result, those who are unprepared for the changes may experience additional cost and delays along their whole supply chain.

▶ Regulation and compliance

There is still some uncertainty regarding what “behind border” trade barriers might be erected between the UK and the EU once the transition period ends. These barriers could include new regulatory requirements, licensing obligations, type approvals, labeling and marking, conformity assessments and so forth. The extent and nature of the changes depends on the scope of the UK-EU trade agreement as well as any unilateral measures each side might take to manage resulting changes in the short term.

▶ Trade in services

Services companies will enjoy considerably less access to the EU Single Market under an FTA when compared with membership of the Single Market. Assessing the impact is critical and should be done as soon as possible to give time to adjust.

▶ Talent – workforce and people

From January 2021, the UK will have a new points-based immigration system. EU and European Economic Area (EEA) citizens resident in the UK before 31 December 2020 will have the right to settle provided they apply to the EU Settlement Scheme before 30 June 2021. All businesses should consider their talent and mobility plans and be prepared for restricted rights to work, changes to rules on business travel and social security.



► Tax and finance

Several tax changes will apply regardless of what is agreed between the UK and EU, including import VAT, loss of EU VAT simplifications, changes to systems and reporting, and withholding tax.

All businesses should analyze short- and medium-term cash flow and working capital requirements, recognizing that their customers may take longer to pay while key suppliers may ask for more generous payment terms (at a time when COVID-19 means that many companies have used up cash reserves and banks are tightening lending criteria). Foreign exchange volatility is expected to increase.

► Legal and contracts

The exact nature of the legal and contractual challenges facing businesses will depend on their corporate structure, regulatory landscape and the provisions of the contracts and legal relationships they have with suppliers, customers and services providers. This is before considering the potential for legal divergence from current EU regimes such as competition and State Aid laws, changes to intellectual property rights and potential difficulties in enforcing contracts on current jurisdiction clauses.

► IT, systems and data

Unless a data adequacy ruling is granted for the UK from the EU (or some other separate legal agreement is reached), additional safeguards will be needed to protect the continuity of cross-border flow of personal data from the EU into the UK. Data requirements may change, leaving companies at risk of penalties for data compliance breaches, significantly increasing the financial consequences. Where UK companies process the personal data of EU27-based data subjects, they may need to appoint a representative in the EU (and vice versa for EU businesses).

Companies should also be looking to their IT systems and infrastructure to assess what additional requirements are needed by various business functions to implement the necessary Brexit changes, e.g., customs, procurement and HR.

► Northern Ireland

Now is the time to understand what the Protocol on Ireland/Northern Ireland means for businesses operating in Northern Ireland. Organizations need to prepare to comply with the new administrative requirements, formalities and procedures around customs, VAT and regulations, which will align with the EU as well as the UK in many regards.

Our “Brexit: 100 days to go” guide sets out the top tips to improve readiness and EY contacts in each of these areas. To access this document, please [click here](#).

In our webcast *How Brexit may impact your global indirect tax position* held on 15 October 2020, our panelists consider the value-added tax (VAT) and trade policy implications for global businesses of the upcoming change and the practical steps that businesses can be taking now. Register [here](#) to listen to the recording. ■

For additional information please contact:

Alwyn Hopkins
+ 44 7887 720 002 | alwyn.hopkins@uk.ey.com

Marc Bunch
+ 44 20 7980 0298 | mbunch@uk.ey.com

Sally Jones
+ 44 7900 703 113 | sally.jones@uk.ey.com

UK: Post-Brexit continuity agreements



Current situation

In addition to the UK's efforts to establish a new trading relationship with the EU and negotiate new free trade agreements (FTAs) with the US, Australia and New Zealand, the UK is also seeking to preserve preferential trading terms with those countries and regional blocs with which EU has FTAs and from which the UK benefits while treated as a Member State. These FTAs are referred to as "continuity" agreements. The UK is, for the most part, looking to simply roll-over the existing terms rather than to negotiate additional commitments.

To date, 21 of the 39 continuity agreements have been concluded. Most recently, the UK and Japan announced on 11 September that an agreement in principle has been reached between them. (In fact, the UK/Japan FTA, assuming it's ratified in due course, goes slightly further than the EU/Japan agreement in some regards and slightly less far in others – but in general terms it's a continuity agreement for almost all practice purposes.)

These EU continuity agreements are important to the UK because they are estimated to cover £117b of UK exports every year. They range from full comprehensive FTAs (e.g., Canada) to agreements covering much more specific arrangements (e.g., the UK-Australia Wine Agreement, which covers labeling requirements and recognition of winemaking techniques) and mutual recognition agreements

(which cover conformity assessments conducted on products to ensure that they meet the necessary safety standards).

Once the transition period ends on 31 December 2020, those countries that have been treating the UK as an EU Member State will cease to do so, and a continuity agreement that has been established to clarify the terms of trade between the UK and those countries will revert to the World Trade Organization-level.

Several countries, like Turkey, due to their Customs Union with the European Union, will only be able to agree to an agreement with the UK if the UK and EU are able to conclude their own FTA talks before December 2020. This situation also applies for Andorra and San Marino.

The UK is also looking to upgrade the agreements that were negotiated with Switzerland, Norway and Iceland in the run-up to a possible no-deal Brexit in 2019, which only addressed goods trade and not services trade.

Developing countries

One area where there is a welcome degree of certainty is around tariffs for imports from developing countries. The UK Government has committed to continuing the EU's preferential tariffs schemes for products coming in under the Generalized System of Preferences and the EU's "Everything But Arms" Initiative. This was set out in the Cross-Border Trade Act 2018, the framework legislation allowing the UK to set out a separate VAT and customs duty regime after Brexit. We expect additional secondary legislation to be tabled in due course to set out further details of the schemes.

Immediate concerns for business

- ▶ Businesses should assess whether any of their international trading operations will be impacted if one or more of the continuity agreements which have yet to be agreed upon (see chart below), should not be agreed by 31 December 2020.
- ▶ Businesses should also look to see whether they rely on the preferential market access for trade in services and whether they benefit from protection from discrimination in public procurement opportunities as there are also key concerns that could be impacted as a result of these agreements lapsing.



UK continuity agreements with non-EU countries*	Status
Andean (Colombia, Ecuador and Peru)	Signed
CARIFORUM (Antigua and Barbuda, Barbados, Belize, Bahamas, Dominica, Dominican Republic, Grenada, Guyana, Jamaica, St Christopher and Nevis, St. Lucia, St Vincent and the Grenadines, and Trinidad and Tobago) ¹	Signed
Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama)	Signed
Chile	Signed
Cote d'Ivoire	Signed
Eastern and Southern Africa (Madagascar, Mauritius, Seychelles, Zimbabwe)	Signed
Faroe Islands	Signed
Georgia	Signed
Iceland and Norway ²	Signed
Israel	Signed
Japan	Signed
Jordan	Signed
Kosovo	Signed
Lebanon	Signed
Liechtenstein ²	Signed
Morocco	Signed
Pacific states (Fiji and Papua New Guinea)	Signed
Palestinian Authority	Signed
South Korea	Signed
Southern Africa Customs Union and Mozambique (Botswana, Eswatini, Lesotho, Namibia, South Africa and Mozambique)	Signed
Switzerland ²	Signed
Tunisia	Signed
Ukraine	Signed

1 Suriname has only agreed in principle.

2 This was an agreement which was designed to come into force in the event of a no deal. If the UK achieves a deal with the EU, these agreements will have to be renegotiated.

3 An agreement with Turkey is only possible if the UK agrees to an FTA with the EU.

UK continuity agreements with non-EU countries*	Status
Albania	Ongoing
Algeria	Ongoing
Bosnia and Herzegovina	Ongoing
Cameroon	Ongoing
Canada	Ongoing
East African Community	Ongoing
Egypt	Ongoing
Ghana	Ongoing
Mexico	Ongoing
Moldova	Ongoing
Montenegro	Ongoing
North Macedonia	Ongoing
Serbia	Ongoing
Singapore	Ongoing
Turkey ³	Ongoing
Vietnam	Ongoing

*Andorra and San Marino are dependent on, and will be covered by, any UK-EU trade agreement

For additional information please contact:

George Riddell
+ 44 7385 344 565 | george.riddell@uk.ey.com

Penelope Isbecque
+ 44 113 298 2447 | pisbecque@uk.ey.com

UK: Trade remedies after the transition period

The UK left the European Union (EU) on 31 January 2020 and entered into a transition period under the terms of the UK-EU Withdrawal Agreement. During this period, the rules on trade between the UK and the EU have effectively remained the same, and UK trade policy has been governed by the current EU rules.

From 1 January 2021, the UK will start operating its own independent trade policy, following the end of the transition period. This includes the application of UK tariff rates, as set out in the UK Global Tariff, and the operation of a UK-specific trade remedies regime.

During the transition period the UK's trade remedies position follows that of the EU; there are currently just more than 100 anti-dumping and anti-subsidy EU trade remedy measures, along with further safeguard measures. Once the transition period ends, the UK needs its own trade remedies regime and with that in mind the UK has set up its own regulatory framework and investigations process, which may diverge from that of the EU. This article provides an overview of the new UK rules and implications for businesses.

Background to trade remedies

The World Trade Organization (WTO) allows members to take certain actions to protect their domestic industries from negative impacts caused by defined "unfair" global trade practices. Members can apply trade remedy measures (typically additional customs duties) against imported goods that are being "dumped," benefit from subsidies or give rise to an unforeseen surge in imports.

There are three types of trade remedy measures:

- ▶ **Anti-dumping duties.** These are levied on imports from countries or firms deemed to be "dumping" goods, i.e., selling them below normal value, which then harm domestic industry.
- ▶ **Anti-subsidy/countervailing measures.** These include duties or other actions, such as import quantity restrictions, to imports by businesses that benefit from subsidies in their country of origin.
- ▶ **Safeguards.** These are actions temporarily imposed on imports expected or likely to cause serious damage to domestic industry competing with the imported goods.



The WTO sets out a framework for the application of trade remedies, with procedural rules and specific conditions in certain areas. National governments can establish their own specific trade remedies regimes to undertake detailed investigations that determine whether the relevant criteria have been met for imposition of measures, including evidence of negative impacts (or risk of such impacts in the case of safeguards) to the relevant domestic industry.

The regulatory framework for UK trade remedies

The UK trade remedies regime will be governed by:

- ▶ The Taxation (Cross-border Trade) Act 2018, which sets out the primary legislation describing the principles of dumping, subsidy and safeguard investigations
- ▶ The Trade Remedies (Dumping and Subsidisation) (EU Exit) Regulations 2019, which sets out secondary legislation describing details on conducting dumping and subsidy investigations
- ▶ The Trade Remedies (Increase in Imports Causing Serious Injury to UK Producers) (EU Exit) Regulations 2019, which sets out secondary legislations describing details on conducting safeguard investigations
- ▶ The Trade Bill, which, once it passes, will establish the Trade Remedies Authority (TRA) as an independent body with the functions of undertaking investigations and making recommendations on the imposition of trade remedy measures

Until the TRA is legally established, the Trade Remedies Investigations Directorate (TRID) within the UK's Department for International Trade is undertaking preparatory work for the commencement of the UK trade remedies regime.

Key features of the UK trade remedies regime

The UK trade remedies regime follows the overall WTO framework, but there is flexibility in the approach and some key points of divergence from the current EU regime – both in terms of rules and practical application.

1. Thresholds for UK industry

Domestic producers can request the initiation of a trade remedies investigation as long as minimum market share conditions are met. The UK industry applying for the measure has to have a market share of at least 1%, although a higher market share requirement may be set for specific goods. This could be the case where imports of the relevant goods are particularly high relative to imports from other countries, so there will be a greater impact on the market, or where the UK production market share has been declining for reasons other than dumping or subsidization and so any trade remedy measures will not be effective in countering negative impacts on the domestic industry. There is no similar market share requirement in the EU.

The UK is maintaining the standing requirement consistent with EU and WTO requirements. This requires that the application has to be supported by at least 25% of all UK production of these goods, and not be opposed by producers accounting for a greater share. While this standing requirement is a similar threshold as that applied in the EU, importantly, the EU will consider production across all EU Member States, whereas in the UK, only UK producers will be concerned. This could lead to very different outcomes for current trade remedy measures.

2. Thresholds for imports

The UK will not undertake trade remedy investigations where the volume of dumped or subsidized imports from the relevant country accounts for less than 3% of total imports of like goods, unless the imports from the relevant

exporting countries account for less than 3% individually, but collectively account for more than 7% of total imports into the UK. This is consistent with the WTO rules, but represent higher thresholds than those applied by the EU (which are 1% for individual countries and 3% collectively of total imports into the EU).

In the case of subsidized goods imported from developing countries, investigations will be terminated if those imports comprise less than 4% of total imports from an individual developing country, unless the volume of imports from a number of developing countries collectively account for more than 9% of total imports. The definition of “developed” and “developing” countries will be a matter of UK Government policy.

3. Target prices for injury margins

The injury to the domestic industry is usually based on a comparison between a “target price” and the actual import price. The target price represents the price that would have applied in the domestic market in the absence of dumped or subsidized imports. This target price is to be estimated as the UK cost of production plus selling, general and administrative costs, and the “normal” rate of profit, which is determined on the basis of a number of factors. The UK rules do not go as far as the EU rules, which explicitly state that the cost of production should consider costs arising from adhering to environmental and labor standards. Further, under EU rules, the level of profitability should account for full costs and investment, research and development, and innovation, and should not be lower than 6%.



4. Lesser duty rule

The lesser duty rule states that the additional duties applied on dumped or subsidized imports should be at the lower of the dumping margin, or the injury margin, i.e., at a level that is sufficient to remove injury. The EU has recently adopted a more nuanced approach to the lesser duty rule; it will not necessarily apply in dumping investigations where there are structural distortions for raw materials in the exporting country, and it will not apply in subsidy investigations unless it is in the EU interest.

Importantly, once the UK trade remedies regime is operational, such measures can also apply on goods traded between the UK and EU.

Transition reviews

The TRID is already undertaking transition reviews to determine whether existing EU trade remedy measures should be maintained, adjusted or terminated for the UK. They are reviewing the measures in the UK context, with UK-specific data, to consider whether the continuing application of a measure is necessary to offset the dumping or import of subsidized goods, and whether there would be injury to the relevant UK industry if the measure was removed. Current EU safeguard measures will be maintained if it is in the UK interest.

Of the current EU measures, the TRID has determined that around 60% will be terminated at the end of the transition period, as they would not meet the relevant criteria when considering just UK data and rules, rather than wider EU production and trade.

Implications for businesses

There will be significant changes for businesses operating in, or trading with, the UK after the transition period ends. The specifics of some of these changes will be determined by any free trade agreement that is negotiated and ratified between the UK and the EU. Even if there is such an agreement, there will still be changes in certain areas such as UK tariffs that apply on goods coming in from all other countries, and the application of UK trade remedy measures in the form of additional duties on certain goods.

Businesses can start preparing now by:

- ▶ Identifying the current EU trade remedy measures under review
- ▶ Assessing which trade remedies are relevant to their operations, either directly or indirectly upstream or downstream in their supply chain
- ▶ Engaging with TRID to support their assessments on whether to continue, amend or terminate measures
- ▶ Understanding the new trade remedies investigation rules and procedures that will apply, including how to engage with TRID (and TRA when operational) rather than the European Commission
- ▶ Estimating the impact of changes in trade remedy measures on their operations and cost base
- ▶ Securing their supply chain
- ▶ Preparing evidence to apply for initiation of new investigations against imported goods that are harming the domestic industry ■

For additional information please contact:

Rushmila Alam

+ 44 20 7951 8457 | rushmila.alam@uk.ey.com

Emma Kissane

+ 44 20 7760 9253 | emma.kissane@uk.ey.com

Tax Alerts

Tax Alerts

Tax Alerts

Americas

Brazil

- ▶ Brazil's tax reform proposal would affect taxpayers participating in certain special regimes, including customs incentives (10.08.2020)

Canada

- ▶ US initiates Section 301 investigation into Vietnam currency policy; files WTO appeal on Canada lumber finding (08.10.2020)
- ▶ Newfoundland and Labrador issues budget 2020-21 (01.10.2020)
- ▶ US replaces 10% punitive tariff on Canadian-origin aluminum with quota limits; Canada suspends contemplated countermeasures (16.09.2020)
- ▶ US imposes 10% punitive tariff on Canadian-origin aluminum; Canada announces countermeasures in response (07.08.2020)
- ▶ Prince Edward Island issues budget 2020-21 (19.06.2020)

Colombia

- ▶ Colombia updates regulations on tax incentives for investments in renewable energy sources (22.06.2020)

Mexico

- ▶ Mexico's President submits 2021 economic proposal to Congress (18.09.2020)
- ▶ Mexico amends customs rules for 2020, impacting maquiladoras and others (03.08.2020)

OECD

- ▶ OECD issues report to G20 finance ministers and Central Bank governors and hosts webcast to provide update on tax work (29.07.2020)

Panama

- ▶ Panama's National Assembly approves bill creating "EMMA" special regime for manufacturing services (18.08.2020)
- ▶ Panamanian Ministry of Commerce and Industries proposes creating special regime for manufacturing services (30.07.2020)

Puerto Rico

- ▶ Puerto Rico enacts additional COVID-19 stimulus measures with implications for tax years 2019 and 2020 (19.06.2020)

US

- ▶ EU responds to WTO authorization to impose countermeasures on US products (20.10.2020)
- ▶ USTR issues Statement asserting lack of legal basis in response to WTO Authorization of EU Countermeasures on US goods under Aircraft Dispute (16.10.2020)
- ▶ US initiates Section 301 investigation into Vietnam currency policy; files WTO appeal on Canada lumber finding (08.10.2020)
- ▶ US replaces 10% punitive tariff on Canadian-origin aluminum with quota limits; Canada suspends contemplated countermeasures (16.09.2020)
- ▶ USTR announces modifications to tariffs on EU goods under Section 301 (14.08.2020)
- ▶ US imposes 10% punitive tariff on Canadian-origin aluminum; Canada announces countermeasures in response (07.08.2020)

US (continued)

- ▶ US imposes new economic sanctions related to China and issues executive order on Hong Kong normalization status that will produce additional supply chain diligence responsibilities (16.07.2020)
- ▶ USTR formalizes duty actions regarding France's Digital Services Tax with deferred implementation to 2021 (13.07.2020)
- ▶ US Government suspends defense exports and EAR export license exceptions for exports to Hong Kong (10.07.2020)
- ▶ USTR proposes carousel tariff retaliation on EU goods under Section 301 (26.06.2020)
- ▶ Ways & Means trade hearing discusses BEPS 2.0 news (18.06.2020)

Asia-Pacific

China

- ▶ US imposes new economic sanctions related to China and issues executive order on Hong Kong normalization status that will produce additional supply chain diligence responsibilities (16.07.2020)
- ▶ China announces masterplan for Hainan Free Trade Port (25.06.2020)

Hong Kong

- ▶ US imposes new economic sanctions related to China and issues executive order on Hong Kong normalization status that will produce additional supply chain diligence responsibilities (16.07.2020)
- ▶ US Government suspends defense exports and EAR export license exceptions for exports to Hong Kong (10.07.2020)

Japan

- ▶ Japan and UK sign Comprehensive Economic Partnership Agreement (03.11.2020)
- ▶ UK secures first free trade agreement with Japan post Brexit (14.09.2020)

OECD

- ▶ OECD issues report to G20 finance ministers and Central Bank governors and hosts webcast to provide update on tax work (29.07.2020)

Vietnam

- ▶ US initiates Section 301 investigation into Vietnam currency policy; files WTO appeal on Canada lumber finding (08.10.2020)
- ▶ EU-Vietnam free trade agreement enters into force as of 1 August 2020 (15.07.2020)

Europe, Middle East, India and Africa

East African Community

- ▶ East African community implements trade and duty changes (16.07.2020)

EU

- ▶ EU responds to WTO authorization to impose countermeasures on US products (20.10.2020)
- ▶ USTR issues Statement asserting lack of legal basis in response to WTO Authorization of EU Countermeasures on US goods under Aircraft Dispute (16.10.2020)
- ▶ European Union imposes further anti-dumping duties on steel imports (12.10.2020)
- ▶ Council of the European Union publishes Draft Directive on identification of taxable persons in Northern Ireland (30.09.2020)
- ▶ European Commission publishes new Guidance on Customs Valuation (29.09.2020)
- ▶ European Court of Justice rules value of free of charge supplied software should be added to customs value (16.09.2020)
- ▶ USTR announces modifications to tariffs on EU goods under Section 301 (14.08.2020)
- ▶ European Council adopts conclusions on recovery plan and EU budget for 2021-2027, including agreement on introduction of new taxes (22.07.2020)
- ▶ European Commission publishes action plan for fair and simple taxation: A detailed review (20.07.2020)

EU (continued)

- ▶ European Commission proposes revision of directive on administrative cooperation (20.07.2020)
- ▶ European Commission adopts package for fair and simple taxation (16.07.2020)
- ▶ European court of justice rules royalty paid for know-how required for manufacture of finished products in the EU may need to be added to customs value of imported semi-finished products (15.07.2020)
- ▶ EU-Vietnam free trade agreement enters into force as of 1 August 2020 (15.07.2020)
- ▶ European Commission publishes new rules for applying tariff quota in agricultural sector as of 1 January 2021 (15.07.2020)
- ▶ USTR proposes carousel tariff retaliation on EU goods under Section 301 (26.06.2020)

France

- ▶ USTR formalizes duty actions regarding France's Digital Services Tax with deferred implementation to 2021 (13.07.2020)

India

- ▶ CBIC issues notification for administration of Rules of Origin under Trade Agreements (25.08.2020)

Ireland

- ▶ Ireland issues Budget for 2021: Review of indirect tax and environmental measures (14.10.2020)

Luxembourg

- ▶ Luxembourg Draft Budget Law 2021 – A look at the tax measures affecting companies (16.10.2020)

Kenya

- ▶ Kenya adjusts specific excise duty rates for inflation (12.10.2020)
- ▶ Kenya's Tax Appeals Tribunal issues landmark ruling on chargeability of Excise Duty on various income streams (24.09.2020)
- ▶ Kenya revises list of dutiable goods that may be warehoused in a bonded facility (31.08.2020)
- ▶ Kenya enacts Finance Act, 2020 (06.07.2020)

OECD

- ▶ OECD issues report to G20 finance ministers and Central Bank governors and hosts webcast to provide update on tax work (29.07.2020)

Poland

- ▶ Poland implements new charge on certain beverages from 1 January 2021 (27.10.2020)

South Africa

- ▶ South African Government releases draft 2020 Tax Law Amendment Bills (06.08.2020)

Tanzania

- ▶ Tanzania's Parliament passes Finance Bill, 2020 (19.06.2020)

Turkey

- ▶ Turkey extends application of temporary and high rate of Additional Customs Duties through 31 December 2020 (05.10.2020)

UK

- ▶ Japan and UK sign Comprehensive Economic Partnership Agreement (03.11.2020)
- ▶ UK issues guidance on accounting for VAT on goods moving between Great Britain and Northern Ireland from 1 January 2021 (29.10.2020)
- ▶ UK issues new guidance on Brexit and UK imports (13.10.2020)
- ▶ Council of the European Union publishes Draft Directive on identification of taxable persons in Northern Ireland (30.09.2020)
- ▶ UK issues response on consultation on duty-free and tax-free goods carried by passengers (17.09.2020)
- ▶ UK secures first free trade agreement with Japan post Brexit (14.09.2020)
- ▶ UK releases new technical guidance for manufacturers (08.09.2020)
- ▶ UK issues Brexit guidance on moving goods under the Northern Ireland Protocol (26.08.2020)
- ▶ UK government releases guidance on moving goods between the EU and Great Britain as of 1 January 2021 (15.07.2020)
- ▶ European Commission publishes communication on Brexit readiness (14.07.2020)
- ▶ UK announces new measures to support customs intermediaries and controls for importing goods will now apply from July 2021 (18.06.2020)

Zambia

- ▶ Zambian government issues 2021 budget (05.10.2020)

Additional resources



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Contacts

Global



Gijsbert Bulk
*EY Global
Indirect Tax
Leader*



Jeroen Scholten
*EY Global
Trade Leader*

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*EY ASEAN
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Global Trade
Partner*



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*EY UK Trade
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Leightman**
*EY Americas
Global Trade
Partner*



**William
Methenitis**
*TradeWatch
Editor*



Yoichi Ohira
*EY Japan Indirect
Tax Leader*



**Martijn
Schippers**
*EY Netherlands,
Indirect Taxation
and Global Trade*

Contacts

Contacts

Regional Global Trade leaders

Robert Boehm
EY Germany, Switzerland and Austria Global Trade Leader

Neil Byrne
EY Global Trade Leader EMEA Tax Center

Ian Craig
EY Latin America South Global Trade Leader

Johnathan Fillis
EY Africa Global Trade Leader

Sylvian Golsse
EY Canada Global Trade Leader

Pedro Gonzalez-Gaggero
EY Mediterranean Global Trade Leader

Michael Heldebrand
EY US Global Trade Leader

Narve Løvø
EY Nordics Global Trade Leader

Rocio Mejia
EY Latin America North Global Trade Leader

Aron Nagy
EY Central Europe, Southern Areas and Russia Global Trade Leader

Suresh Nair
EY India Global Trade Leader

Dongo Park
EY Korea Global Trade Leader

Paul Smith
EY Oceania Global Trade Leader

Bryan Tang
EY Greater China Global Trade Leader

Donald Thomson
EY Asia Pacific Tax Centre Global Trade Leader

Contacts



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