

# TradeWatch



## In this issue

### Spotlight on

#### New US free trade agreements

New US FTAs with South Korea, Colombia and Panama highlight the benefits and complexities of FTA management.....	2
South Korea – US free trade agreement.....	4
Colombia – US free trade agreement .....	5
Panama – US free trade agreement .....	7

#### Global

WCO approves commentary on royalties but controversy remains unsettled.....	9
Mutual recognition of C-TPAT and AEO to take effect next summer .....	11
Ernst & Young's Global Customs and International Trade practice publishes new report: <i>Global trade management: adapting to polycentric markets</i> .....	12

#### Americas

Mexico implements new export control program.....	13
Harsher sanctions for customs non-compliance by maquiladoras .....	15
NAFTA – Mexico eliminates retaliatory duties against the United States .....	17
United States – US Customs incorporates statistical sampling and payment offsetting in audit and prior disclosure procedures .....	18
US Customs considers changing the impact of post-importation transfer pricing adjustments.....	20
Renewal of the US Generalized System of Preferences.....	21
Merchandise processing fee increased, but for how long? .....	22

#### Asia Pacific

Australian Tribunal decision opens the door for importers seeking tariff concessions.....	23
Japan Customs sheds light on the customs treatment of retroactive transfer pricing adjustments.....	25
New protocol strengthens the Japan – Mexico economic partnership agreement .....	27

#### Europe, Middle East, India and Africa

Turkey implements new settlement practice for customs disputes .....	28
New CIS rules of origin now effective in Ukraine as preferential trade moves closer to free trade .....	30
Ukraine adopts new Customs Code .....	33
Ukraine cancels export duties on grain .....	34

## New US free trade agreements

### New US FTAs with South Korea, Colombia and Panama highlight the benefits and complexities of FTA management

The congressional bills to implement the US free trade agreements (FTAs) with South Korea, Colombia and Panama have gained congressional approval and President Obama's signature, thus paving the way for the long-awaited realization of the agreements and their inherent trade benefits and opportunities.

#### Overview: new US FTAs with South Korea, Colombia and Panama

The FTAs provide for preferential trade between the United States and each party to the respective agreement. Importers and exporters in each country have the potential for more competitive access to additional markets under preferential trade conditions, including reduced or zero tariffs. At the same time, businesses need to be aware of the FTA requirements, particularly with respect to origin and special provisions for certain products and industries.

We highlight below some of the important aspects of each of the three new US FTAs.

US FTA	South Korea	Colombia	Panama
Estimated implementation time frame	January 2012	First quarter of 2012	First quarter of 2012
Tariff benefits: consumer/ industrial goods	90% of US goods become duty-free immediately with 10-year phase-out for most remaining tariffs	80% of US goods become duty-free immediately with 10-year phase-out for most remaining tariffs	87% of US goods become duty-free immediately with 10-year phase-out for most remaining tariffs
	78% of South Korean goods become duty-free immediately, which increases to 93% within five years	99% of Colombian goods become duty-free immediately	99% of Panamanian goods become duty-free immediately
Tariff benefits: agricultural goods	Almost 2/3 (by value) of US goods become duty-free immediately with 10-year phase-out for most remaining tariffs	More than 70% of US goods become duty-free immediately with 15-year phase-out for most remaining tariffs	More than 50% of US goods become duty-free immediately with 15-year phase-out for most remaining tariffs
	Phase-out of all tariffs for South Korean goods over a 15-year period	Almost all Colombian goods become duty-free immediately	Almost all Panamanian goods become duty-free immediately
Direct shipment requirement	Yes; includes provisions to encourage customs monitoring for textile and apparel trade	Yes	Yes; includes provisions to encourage customs monitoring for textile and apparel trade and Panamanian free trade zones



US FTA	South Korea	Colombia	Panama
Primary responsibility for compliance	Importer	Importer	Importer
Provides for customs verification visits at the exporter's premises	Yes	Yes	Yes
Industries with special provisions	<ul style="list-style-type: none"> <li>▶ Agriculture</li> <li>▶ Automotive</li> <li>▶ Textile and apparel</li> <li>▶ Pharmaceuticals and medical devices</li> </ul>	<ul style="list-style-type: none"> <li>▶ Agriculture</li> <li>▶ Telecommunications</li> <li>▶ Textile and apparel</li> </ul>	<ul style="list-style-type: none"> <li>▶ Agriculture</li> <li>▶ Textile and apparel</li> </ul>
Safeguard measures	<ul style="list-style-type: none"> <li>▶ Tariff-rate quotas for certain agricultural goods</li> <li>▶ Automotive-specific safeguard measures</li> </ul>	<ul style="list-style-type: none"> <li>▶ Tariff-rate quotas for certain agricultural goods</li> <li>▶ Textile-specific safeguard measures</li> </ul>	<ul style="list-style-type: none"> <li>▶ Tariff-rate quotas and safeguard measures for certain agricultural goods</li> <li>▶ Textile-specific safeguard measures</li> </ul>
Provides for advance rulings	Yes	Yes	Yes
Provides for government procurement opportunities	Yes	Yes	Yes
Additional standards	High standards of labor, environmental commitments and intellectual property right protections	High standards of labor, environmental commitments and intellectual property right protections	High standards of labor, environmental commitments and intellectual property right protections; tax transparency practices

More detail on each of the agreements is contained in this issue of TradeWatch.

The new US FTAs provide a great opportunity to revisit FTA planning worldwide. The FTA environment is quite dynamic, and it is important to remember that FTA benefits are conditioned on meeting and documenting specific requirements. Businesses that can effectively optimize this planning, however, can often secure a competitive advantage in a variety of markets.

For additional information, contact Bill Methenitis, *Dallas*, Ernst & Young LLP (United States) at [william.methenitis@ey.com](mailto:william.methenitis@ey.com) (Tel. +1 214 969 8585) or Kristine Price, *Dallas*, Ernst & Young LLP (United States) at [kristine.price@ey.com](mailto:kristine.price@ey.com) (Tel. +1 214 969 8602).

# South Korea – US free trade agreement



With the passage of the South Korea-US free trade agreement (KORUS) by both the US and Korea, the FTA is quickly moving closer to implementation of what will be the 50th country that South Korea has entered into a trade deal with and the second largest FTA for the US. The agreement would come into effect 60 days from 22 November 2011 (i.e., the date of South Korean ratification); however, both sides are working to meet a goal to implement KORUS on 1 January 2012.

## Preferential tariffs and trade

The duty reduction schedule calls for US tariffs to be eliminated on nearly 78% of South Korean exports upon implementation. Within five years after implementation, 93% of South Korean exports will have duty-free access to the United States – including many textiles and agricultural products as well as auto parts, passenger cars, LCD monitors, camcorders, television sets, among many other items. Likewise, nearly 95% of US consumer and industrial products gain duty-free access to South Korea within five years, while US agricultural imports benefit from the phase-out of tariffs and quotas.

KORUS provides the opportunity for the parties to gain more business certainty from a compliance perspective for complex issues through advance rulings. The provisions of the agreement state that advance rulings be issued within 90 days of request. Advanced rulings can cover a wide range of issues, including origin qualification, tariff classification, customs valuation and the applicability of duty drawback, among other issues specified in the agreement.

KORUS also provides for expedited customs clearance, with most goods clearing customs within 48 hours after arrival. The KORUS provisions allow goods to be declared for clearance prior to port arrival, have goods clear customs directly from the pier, or allow goods to be released before the duty and other import taxes are finalized. The emphasis is also on the use of electronic clearance procedures to facilitate quicker clearance of imported goods.

## Strong customs enforcement provisions

Businesses accessing the agreement's benefits need to recognize the inherent compliance responsibilities, particularly considering the strong enforcement provisions provided in KORUS to ensure that preferential trade is only granted to qualifying goods. KORUS does allow the manufacturer, exporter, or importer to self-declare the origin of the goods. Customs authorities can request documentation to support the origin claim, and KORUS also provides strong customs cooperation provisions, including on-site verifications by the importing country's customs authorities at the exporter or producer's premises to verify origin details under certain circumstances. Textile-specific provisions also allow for unannounced verification visits, particularly to address concerns regarding illegal transshipment. The textile and automotive sectors are also subject to strong enforcement provisions to protect against import surges for certain sensitive goods.

## KORUS expands global trade opportunities

Overall, KORUS represents significant opportunities for South Korean and American manufacturers to expand opportunities in each other's markets and drive costs down to gain a competitive advantage. Further, the agreement can serve to complement each country's existing FTAs. For instance, by adding KORUS to South Korea's mix of FTAs, which include agreements with the EU and ASEAN, South Korean products have unparalleled access to the world's largest consumer markets. With the benefits of KORUS closer to realization, FTA planning is getting even more attractive – and rewarding.

---

For additional information, contact Scott Fife, *Seoul*, Ernst & Young Han Young at [scott.fife@kr.ey.com](mailto:scott.fife@kr.ey.com) (Tel. +82 2 3770 0963)

# Colombia – US free trade agreement



Five years after the initial signing, the free trade agreement between Colombia and the US (CFTA) has finally gained US approval. CFTA includes preferential tariff and trade provisions that benefit trade in goods and investment (among other provisions) along with commitments in areas, such as labor and the environment. Colombia is in the process of implementing the agreement, with optimistic estimates that the agreement could come into effect as early as the first quarter of 2012.

## Preferential trade

Upon implementation, approximately 99% of Colombian exports will gain duty-free access to the US. Many of these goods already benefit from preferential tariffs under the Andean Trade Preferences Act (ATPA). However, CFTA is not subject to periodic review and renewal by the US government, which often times has led to a lapse in the ATPA program, resulting in cash flow issues for traders along with additional administration to seek refunds once reinstated. Additionally, changes can be made to the list of goods (and countries) eligible for ATPA benefits whereas under CFTA, the parties have agreed not to increase duties or adopt new duties for originating goods. In other words, CFTA preferential treatment is considered permanent, allowing for longer-term planning by business. We note that eligible Colombian exports will continue to benefit under the ATPA until CFTA goes into force; thereafter, entries from Colombia will benefit only under CFTA.

For US exports, more than 80% of consumer and industrial products and more than half of agricultural products will become duty-free immediately, with remaining tariffs phased-out over 10 years (for consumer and industrial products) and 15 years (for agricultural products). Textiles and apparel, in particular, benefit from tariff and quota elimination immediately, subject to the agreement's rules of origin and textile-specific safeguard provisions.

## Origin requirements

CFTA preferential access requires that the product meet the agreement's rules of origin. CFTA recognizes the origin of goods wholly obtained or produced entirely in the territory of one or more of the parties. In the case of produced goods, the rules generally apply a tariff shift or regional value content requirement (with varying minimum percentages), depending on the product. Special origin rules were established for goods of the automotive and textiles and apparel sector.

Other product-specific origin rules may also apply that establish quantitative limitations or percentage participation limitations over the final good obtained. For example, coffee requires a change to tariff heading 0901 from any other chapter to confer Colombian origin, but with specified quantitative limitations that increase over a five-year period.

We also note that CFTA allows goods produced in Colombia's free trade zones (FTZ) to qualify for preferential treatment, assuming the origin rules are met. This aspect of the agreement further accentuates the attractiveness of Colombia's FTZ program.

CFTA provides for simplified procedures with respect to certificates of origin. The importer makes the claim for preferential tariff treatment based on either (1) a written or electronic certification by the importer, exporter or producer, or (2) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the good is an originating good. While US traders may be more accustomed to this procedure, this is a significant simplification for Colombian traders, which generally must obtain formal certificates of origin issued by the certifying body (Ministry of Trade, Industry and Tourism) for preferential origin claims. However, this simplification places a post-importation responsibility on the trader, which must be able to support the origin claim upon request by the customs authorities and adhere to the agreement's record-keeping obligations.



### ***Expedited customs clearance***

Another benefit is CFTA's commitment to expedited customs clearance with most goods clearing customs within 48 hours after arrival. CFTA provisions allow goods to be released at the point of arrival, without temporary transfer to warehouses or other facilities. Likewise, commitments were made to automate the entire customs clearance for risk analysis and targeting, thus promoting the development of electronic systems between the customs authorities of both countries to facilitate information exchange.

### ***Advance rulings***

CFTA provides for an advance rulings process, which will be effective three years after the implementation of the agreement. Accordingly, importers and exporters can request a binding ruling from their respective customs authorities with regard to issues, such as tariff classification, customs valuation, country of origin and the application of duty drawback, and deferral or other relief from customs duties (among other topics specified in the agreement). The agreement provides that advance rulings will be issued within 150 days from the date of request, provided that all required information has been submitted.

### ***Preferential investment***

CFTA has an investment chapter that covers investments made prior to the enforcement of the FTA, and stipulates various special protection standards, including those related to indemnity and indirect expropriations, minimum treatment levels and assurance of transfers (i.e., those related with the repatriation of profits or sums generated as a result of the liquidation of an investment). These provisions increase the protection of US investors in Colombia and vice versa.

In addition, the agreement provides a state dispute settlement mechanism for the investor. There is a consultation and negotiation stage (includes the use of non-binding, third party procedures) as well as an arbitration stage, which opens the possibility to bring the defaulting state to an international court governed by the International Centre for Settlement of Investment Disputes rules of procedures for arbitration proceedings. This is a significant provision, as prior to CFTA, any such claim had to be resolved through the local courts.

These provisions aim to increase investor confidence, particularly with respect to US foreign direct investment in attractive fields of the Colombian economy, such as in the industrial sector (machinery production, equipment and the generation of bio-fuels), services (financial and software) and agricultural (chicken farming and milk products), among others.

### ***Closing thoughts***

Colombia's new FTA with the United States has the potential to expand business opportunities for US and Colombian companies. US products, particularly machinery and industrial goods, raw materials and plastics, as well as agricultural commodities like cotton and corn, will have preferential access to a market of almost 50 million people. At the same time, successful implementation will require regulatory reforms on behalf of Colombia, including modernization of customs procedures and strengthening of labor and environmental standards along with infrastructure improvements. Accordingly, government initiatives in this respect will be key to defining the actual impact of the agreement.

---

For additional information, contact Gustavo Lorenzo, Bogotá, Ernst & Young Ltda. at [gustavo.lorenzo@co.ey.com](mailto:gustavo.lorenzo@co.ey.com) (Tel. +57 (1)4847225).

# Panama – US free trade agreement



Panama's free trade agreement with the United States (PAN-US FTA) has gained approval by the US Congress and President Obama, five years after the initial signing and ratification by the Panamanian government. During the interim, the Government of Panama implemented a variety of legislative and administrative actions to appease concerns of the US government prior to approval, such as tax transparency (Panama entered into a Tax Information Exchange Agreement with the US in April 2011) and strengthening labor laws and enforcement. The agreement is expected to enter into force during the first quarter of 2012.

The PAN-US FTA is a comprehensive FTA that provides for significant liberalization of trade in goods and services, including financial services. It also includes important disciplines relating to customs administration and trade facilitation, technical barriers to trade, government procurement, investment, telecommunications, electronic commerce, intellectual property rights, and labor and environmental protection. We highlight below some of the agreement's preferential tariff and trade benefits.

## Tariff reductions

The PAN-US FTA provides for immediate duty-free treatment of most Panamanian goods entering the US and staged duty elimination for remaining tariffs. The agreement replaces the duty-free preferences provided by Panama's unilateral agreements with the US (i.e., the Caribbean Basin Economic Recovery Act (CBERA) and the Generalized System of Preferences (GSP)). By comparison, the preferential tariffs provided in the PAN-US FTA agreement are permanent in that there are no periodic renewals (and thus, no risk of detrimental lapses of the agreement) and neither party can increase or adopt new tariffs.

We note that eligible Panamanian exports will continue to benefit under CBERA and GSP until the PAN-US FTA enters into force; thereafter, exports will only benefit from the PAN-US FTA, with certain exceptions.

For US imports, approximately 87% of industrial and commercial goods benefit from duty-free access immediately with the remaining tariffs phased-out over a 10-year period. Additionally, more than half of US agricultural exports benefit from immediate duty-free treatment with longer phase-out periods for the remaining tariffs, particularly for rice.

Qualification for the PAN-US FTA's preferential tariffs is subject to the agreement's comprehensive rules of origin. Considering Panama's role as a transshipment hub, particularly with respect to the Colon free trade zone, it is important that the origin rules are followed closely, particularly with respect to regional value content rules and record-keeping requirements to safeguard the duty savings. For instance, the agreement includes a customs cooperation provision to monitor potential illegal transshipment issues, including possible on-site verification visits by the customs authorities.

Additionally, the agreement includes some protective measures, such as safeguard provisions (to protect against import surges) and tariff rate quotas for certain sensitive products (e.g., Panamanian sugar, bovine and pork meat, milk, cheese, rice, processed tomatoes, vegetable oils and textiles).

## Improved transparency for investors

Another important aspect of the PAN-US FTA is that the agreement promotes US foreign direct investment in Panama with rules that provide for transparency and non-discriminatory treatment as well as comprehensive dispute settlement provisions. When coupled with the government procurement provisions, which also promote non-discriminatory treatment, the agreement makes many investment prospects, such as plans to expand the Panama Canal, attractive for US investors.

Given that the PAN-US FTA is finally moving forward, the time is ripe for businesses to consider the agreement's preferential tariff and trade benefits in supply chain planning and investment decisions. As with any preferential trade program, compliance with origin and related requirements should be addressed proactively with established procedures and internal controls to safeguard duty savings.

---

For additional information, contact Gabriela Silis, *San Salvador*, Ernst & Young El Salvador, S.A. de C.V. at [gabriela.silis@sv.ey.com](mailto:gabriela.silis@sv.ey.com) (Tel. 503 2248 7015), Guillermo López, *Panama*, Ernst & Young Panama S.A. at [guillermo.lopez@pa.ey.com](mailto:guillermo.lopez@pa.ey.com) (Tel. +507 208-0105) or Juan Carlos Chavarría, *San José*, Ernst & Young (Costa Rica) at [juan-carlos.chavarria@cr.ey.com](mailto:juan-carlos.chavarria@cr.ey.com) (Tel. +506 2208-9844).



## WCO approves commentary on royalties but controversy remains unsettled



The World Customs Organization (WCO) Technical Committee on Customs Valuation (TCCV) has issued a new commentary on royalties. Commentary 25.1 deals specifically with royalties or license fees paid by the importer of products to a third party licensor unrelated to the seller, such as commonly occurs with licenses of trademarks. While the commentary is the culmination of several years of discussions by the TCCV, it seems unlikely to add any certainty to the required analysis.

The TCCV is a committee of customs authorities created by the World Trade Organization (WTO) valuation agreement and tasked with providing interpretation and guidance on the Valuation Agreement. It is administered by the WCO. While its guidance is not binding on any jurisdiction, its pronouncements are regularly cited by customs authorities worldwide.

### Background

The valuation agreement provides that royalties paid by the importer of product to someone other than the seller of the product must be added to the price paid for the product to determine transaction value when the royalty:

- ▶ Is related to the imported product
- ▶ Must be paid as a condition of the sale to the importer

As reported in prior editions of *TradeWatch* (most recently, December 2010), the TCCV has been evaluating case studies on the subject for several years, focused on the second factor. Customs authorities have not expressed consistent views on how to determine if a royalty must be paid as a condition of sale. While all agree that a contractual provision in the product sales agreement that requires payment of the royalty in order for the seller to sell product to the buyer is a condition of sale, there is disagreement on whether, and how, a condition of sale may be implied when no legal condition exists.

### Commentary 25.1

Commentary 25.1 states that the clearest indication that the royalty must be paid as a condition of sale occurs when the sales documentation requires payment of the royalty. The TCCV acknowledges that sales documentation often has no explicit provision, and lists other factors that “could be taken into account” in determining whether or not payment of the royalty is a condition of the sale. The stated factors are:

- ▶ A reference in the sales agreement or sales documentation to the royalty
- ▶ A reference to the sale of goods in the license agreement
- ▶ A cross default clause, by which the sales agreement can be terminated if the buyer fails to pay the royalty
- ▶ A term in the license agreement that forbids the seller to sell to the buyer if the buyer fails to pay the royalty
- ▶ The license agreement contains terms that permit the licensor to manage the production or sale of products between the manufacturer and the importer that go beyond quality control

The list of factors provided in Commentary 25.1 is not comprehensive, however. The commentary states that a determination of whether a condition of sale exists “depends on all the facts surrounding the sale and importation of the goods,” and concludes with the sentence: “[e]ach case must be considered individually having regard to the relevant circumstances.”



## Little comfort for importers

The approach taken in Commentary 25.1 provides little comfort for importers. While importers do know that the factors listed are important, the “facts and circumstances” approach taken by the TCCV leaves open for interpretation what other factors may also be important. Customs authorities have historically had quite divergent views on what factors may be considered relevant; the open-ended approach to Commentary 25.1 seems unlikely to alter those views. In fact, the TCCV is expected to discuss additional fact patterns involving trademark royalties at their spring meeting.

---

For additional information, contact Bill Methenitis, *Dallas*, Ernst & Young LLP (United States) at [william.methenitis@ey.com](mailto:william.methenitis@ey.com) (Tel. +1 214 969 8585).

# Mutual recognition of C-TPAT and AEO to take effect next summer



The EU-US Transatlantic Economic Council announced on 29 November 2011 that the US Department of Homeland Security and the EU Directorate for Trade have completed preparatory work on mutual recognition of the US Customs-Trade Partnership against Terrorism (C-TPAT) and the EU Authorized Economic Operator (AEO) supply chain security partnership programs. Once the mutual recognition decision is completed, qualified C-TPAT and AEO members will enjoy reciprocal benefits. The mutual recognition is expected to be effective in July 2012.

As background, mutual recognition, advocated by the WCO, promotes end-to-end supply chain security and trade facilitation. Through mutual recognition, certified companies benefit from reduced customs controls and priority treatment in additional countries, thus leading to expedited release of goods and more predictability for trade. Additionally, certification provides a competitive edge as companies increasingly look to do business with “secure” business partners.

AEO mutual recognition arrangements are growing globally. For instance, Japan implemented mutual recognition agreements with the EU, South Korea and Singapore earlier this year. The US already has arrangements with New Zealand, Canada, Jordan, Japan and South Korea, and is working toward mutual recognition with Singapore. The EU also has arrangements with Switzerland and Norway, and is working toward mutual recognition with China. These are just a few examples of existing and upcoming arrangements. Overall, these mutual recognition arrangements serve to strengthen supply chain security programs, thereby increasing their effectiveness and expanding the benefits for certified companies.

This latest development is welcome news for the more than 10,000 participants in the US C-TPAT program, and for the 4,600 EU AEO participants. Businesses that conduct trade between the US and EU that are not part of either program may wish to reconsider participation with mutual recognition on the way.

---

For additional information, contact James Pai, *New York City*, Ernst & Young LLP (United States) at [james.pai1@ey.com](mailto:james.pai1@ey.com) (Tel. +1 212 773 5576).

# Ernst & Young's Global Customs and International Trade practice publishes new report: *Global trade management: adapting to polycentric markets*



*Global trade management: adapting to polycentric markets*, the new thought leadership report from Ernst & Young's Customs and International Trade practice, explains how the concept of "globalization" is changing, and how multinational companies' international trade and distribution models are adapting in response.

"This new report explains to executives how companies are organizing their trade functions to distribute material and finished goods successfully and efficiently in the evolved economy," says Phillip Robinson, Global Director of Indirect Tax. "It is an excellent thought leadership piece to foster conversation with companies engaged in strategic planning."

*Global trade management: adapting to polycentric markets* builds on the themes in Ernst & Young's report *Winning in a polycentric world: Globalization and the changing world of business*, published earlier this year, which demonstrates how differing economic circumstances in developed and emerging economies are leading successful companies to evolve their management styles. The report findings conclude that success requires companies to focus on four priorities: redefining "global" and "local," developing a polycentric approach to innovation, rethinking relationships with government and tax administrations, and building diverse leadership teams with strong global experience.

Bill Methenitis, Global Director Customs and International Trade, comments: "*Global trade management: adapting to polycentric markets* discusses how the import, export and logistics functions of multinationals are responding to polycentric globalization. Our findings are based on data obtained during the 2011 Indirect Tax Symposium in Vienna, when trade executives from a variety of industries provided their views on a range of international trade topics." The report covers issues such as achieving landed cost and compliance efficiencies through the "right" level of decentralization, the impact of free trade agreements and strategic sourcing on polycentric distribution models, the role of trade compliance software in balancing centralization and decentralization considerations, and the impact of multi-country cargo security initiatives.

---

For additional information, contact Bill Methenitis, *Dallas*, Ernst & Young LLP (United States) at [william.methenitis@ey.com](mailto:william.methenitis@ey.com) (Tel. +1 214 969 8585), Kristine Price, *Dallas*, Ernst & Young LLP (United States) at [kristine.price@ey.com](mailto:kristine.price@ey.com) (Tel. +1 214 969 8602) or Neil Byrne, *Dublin*, Ernst & Young (Ireland) at [neil.byrne@ie.ey.com](mailto:neil.byrne@ie.ey.com) (Tel. +353 1 221 2370).

## Mexico

### Mexico implements new export control program



On 16 June 2011, the Ministry of Economy published a Decree implementing an export control program, which would bring Mexico into compliance with its obligations under United Nations Resolutions 64/40 and 1540. The Decree consolidates Mexico's existing export control regime and unilaterally adopts the export control lists maintained by the Wassenaar Arrangement, a multilateral arrangement on export controls for conventional weapons and sensitive dual-use goods and technologies. Mexico has requested accession to the Wassenaar Arrangement.

The new export control program entered into force on 20 October 2011. Under the Decree, the items listed in Annexes I-III generally require an export permit from the Ministry of Economy prior to exportation. The annexes include:

- ▶ Annex I: Dual-use goods
- ▶ Annex II: Conventional arms, parts and components
- ▶ Annex III: Software and technology
- ▶ Annex IV: List of countries exempted from permit requirement (currently blank)

One of the major differences from the US version of the control list is a cross-reference to the tariff classifications of controlled items. There are 342 tariff classifications referenced to the controlled items. The references may make it convenient for importers who also export, but exporters must bear in mind that the export control classification numbers (e.g., 1.A.1.b.2) are different from the products' tariff classification. It is the responsibility of the exporter to properly classify the subject goods in accordance with the new export control lists contained in Annexes I through III.

Mexico has adopted a broad definition of "dual-use." Under the new Decree, "dual-use" is defined to include any product, regardless of size, that could be incorporated in both military and civil products or put to military use. Mexico has also taken a broad view of the word "export," which includes transfer of data by electronic media, telephone, fax, satellite or any other means of communication that may be subject to interception. All such activities related to the newly controlled products, software and technology would require an export permit from the Ministry of Economy.

#### Obtaining an export permit

In order to export goods subject to the new controls, exporters will be required to file an "End Use Manifest" and an "Export Permit Request" that contain the following information:

- ▶ Exporter's name and address
- ▶ Foreign importer's name and address
- ▶ Industry or business activity of foreign importer
- ▶ Description of goods to be exported
  - Commercial description
  - Technical specifications
  - Export control classification number
- ▶ End use
- ▶ End user (if different from foreign importer)



Both forms will be submitted electronically for review by the Ministry of Economy's Export Control Directorate. The Directorate will perform a risk analysis of the subject goods to validate the "Export Permit Request" and deliver the export permit to the requesting party. The Ministry of Economy may also deny or cancel an export permit for the following reasons:

- ▶ Exporter submits false information
- ▶ Exporter cannot provide sufficient information or evidence of proper controls surrounding the transaction
- ▶ Ministry of Economy knows or suspects that the transaction violates the law

Assuming the exporter has provided complete information, the "Export Permit Request" process is expected to last no more than 15 business days from the date of submission. Export permits will be valid for one year and may be renewed for the same period as needed.

## Exemptions

Exemptions from the export permit requirement include:

- ▶ Items exported by the Mexican government for use during humanitarian or peace-keeping missions
- ▶ Items exported to the United States or Canada
- ▶ Items exported to countries listed on Annex IV (currently blank)

Exports to the United States and Canada are currently exempted from obtaining an export permit. If Mexico is granted accession to the Wassenaar Arrangement, Annex IV will be the mechanism through which Mexico exempts other countries with similar export control regimes.

## Sanctions

Failure to comply with the Decree and obtain the appropriate export permit may result in fines and penalties as established by Mexico's Foreign Trade Law, Customs Law and other applicable regulations. While specific fines have yet to be determined, exporters should expect fines ranging between USD 150 to USD 250 per export operation not accompanied by the corresponding export permit, among other penalties that would be determined by the Mexican government.

## Implications for business

Mexico's new export control program may pose a substantial risk or at least a new administrative burden to companies that export products, software or technology to countries other than the United States and Canada. Exporters should review the new Decree and its related annexes to determine how the new requirements will impact their business. Any company that believes its products, software or technology are covered by the new export control program should implement procedures to ensure that export permits are obtained on a timely basis and all compliance requirements are met.

---

For additional information, contact Sergio Moreno, *Dallas*, Ernst & Young LLP (United States) at [sergio.moreno@ey.com](mailto:sergio.moreno@ey.com) (Tel. +1 214 969 9718) or Matt Bell, *Dallas*, Ernst & Young LLP (United States) at [matt.bell@ey.com](mailto:matt.bell@ey.com) (Tel. +1 214 969 8378).

# Harsher sanctions for customs non-compliance by maquiladoras



The failure to comply with certain customs obligations could cost maquiladoras their eligibility for the newly extended tax credit against Mexico's flat rate business tax (IETU).

On 12 October 2011, the Mexican tax authorities issued a two-year extension (from 1 January 2012 through 31 December 2013) of the tax credit against the flat rate business tax, known as IETU, which was granted to maquiladoras (companies operating under the IMMEX<sup>1</sup> regime) by the 2007 Calderon Decree. This benefit allows maquiladoras to apply an IETU credit, which will result in their net IETU and income tax liability being equal to the IETU rate (17.5% for 2010 and subsequent years) applied on their income tax base. Accordingly, the tax credit is a significant measure to reduce the income tax burden. However, the failure to comply with certain customs obligations could cost maquiladoras their eligibility for the newly extended tax credit.

## IETU tax credit eligibility now dependent upon customs compliance

Eligibility for this new extension of the tax credit is dependent upon several fiscal requirements that must be met. These requirements include various customs obligations, such as:

- ▶ No final and binding tax (e.g., customs duty, value-added tax) deficiencies, nor assessed tax decisions, whether or not final and binding, that have not been paid or guaranteed
- ▶ Minimum annual exports by the maquiladoras of USD 500,000 or 10% of its total sales
- ▶ Temporary importation of sensitive goods only if the goods are classified under the tariff codes specifically authorized by the Mexican authorities for the maquiladoras' IMMEX program

- ▶ Destination and storage of temporarily imported goods for the purposes and in the locations authorized by said program
- ▶ Proper and timely filings with both the Mexican tax authorities and the Ministry of Economy for any registry requests for modifications relevant to the IMMEX program (e.g., changes to corporate name, tax domicile)
- ▶ An automated inventory control system in accordance with Article 10 of the IMMEX Decree and Annex 24 of the Temporary Regulations to the Mexican Customs Law
- ▶ Maintenance of the corresponding supporting documentation of customs operations
- ▶ Submission of customs compliance documentation and information, as required by the Mexican authorities
- ▶ Correct indication of names and addresses of foreign suppliers, producers or buyers of goods in the corresponding invoices and customs declarations

Failure to comply with any of the aforementioned customs conditions would disallow the application of the IETU tax credit.

<sup>1</sup>Decree for the Promotion of the Manufacturing, Maquiladora and Service Exportation Industry.



## Implications for business

Without the IETU tax credit, maquiladoras would significantly increase their tax burden and thus, the recent announcement of the two-year extension is welcome news. At the same time, eligibility for the tax benefit is not automatic and in effect, the tax credit serves as an incentive to reward companies that comply with fiscal and customs obligations pursuant to the IMMEX decree.

As a result, there is even more focus on customs compliance as the failure to comply could cost maquiladoras their IETU credit eligibility. Maquiladoras cannot afford to overlook what are effectively harsher sanctions for customs non-compliance. With the new provisions taking effect in January 2012, it is essential that maquiladoras act quickly to assess compliance with customs obligations and act quickly to resolve any issues.

---

For additional information, contact Edwin Solano, *Tijuana*, Ernst & Young Mancera, SC, at [edwin.solano@mx.ey.com](mailto:edwin.solano@mx.ey.com) (Tel. +52 166 4681 7844), Roberto Chapa, *Monterrey*, Ernst & Young Mancera, SC, at [roberto.chapa@mx.ey.com](mailto:roberto.chapa@mx.ey.com) (Tel. +52 81 8152 1853), Rocío Mejía, *Mexico City*, Ernst & Young Mancera, SC at [rocio.mejia@mx.ey.com](mailto:rocio.mejia@mx.ey.com) (Tel. +52 55 5283 8672), or Michael Becka, *Dallas*, Ernst & Young LLP at [michael.becka@ey.com](mailto:michael.becka@ey.com).

# NAFTA

## Mexico eliminates retaliatory duties against the United States



The long-running dispute between Mexico and the United States involving cross-border trucking appears to have finally ended with the first authorization granted by the US government to a Mexican trucking company to operate beyond the US border commercial zones and across US territory. With this significant event comes Mexico's elimination of the remaining retaliatory duties against certain US goods, as an update to our article "Mexico reduces retaliatory duties against the United States," in the September 2011 issue of *TradeWatch*.

### The Mexico – US cross-border trucking dispute background

The dispute between Mexico and the United States stemmed from the US failure to implement the North American Free Trade Agreement (NAFTA) provisions that would have provided Mexican cross-border trucking companies access to the US border states by 1995 and full access to the US territory by 2000. Negotiations between the Mexican and US governments finally resulted in an agreement formalized in a Memorandum of Understanding (MOU) signed on 6 July 2011 by the U.S. Department of Transportation and the Mexican Ministry of Economy.

In adhering to terms of phase one of the MOU, the United States implemented a pilot program that allowed approved Mexican trucks to operate in the US interior beyond the 25-mile border region, resulting in a 50% reduction in retaliatory duties by Mexico along with reciprocity with respect to the operation of US trucks in Mexico. The remaining requirement for full elimination of the retaliatory duties was that the US grant full authority for Mexico-domiciled motor carriers to operate in the US interior. The US recently met this requirement, evidenced by the first authorization on 14 October 2011. Therefore, in accordance with the MOU, the Mexican government issued a Decree on 21 October 2011 that eliminated the remaining retaliatory duties.

### What to expect

While the affected tariffs have gone back to normal low or duty-free levels, the saga may not yet be over. The outcome of the pilot program, which continues over a three-year period, will determine whether the US will permanently allow Mexican trucks to operate in the US. Certain US industry groups, such as the truckers unions, remain very vocal about their concerns with respect to how the US will provide proper oversight for Mexican trucks circulating across the US. As the Mexican government has reserved the right under NAFTA to reestablish retaliatory duties if the US does not comply with the full terms of the MOU, the risk of another round of retaliatory duties on US originating goods remains.

---

For additional information, contact Sergio Moreno, *Dallas*, Ernst & Young LLP (United States) at [sergio.moreno@ey.com](mailto:sergio.moreno@ey.com) (Tel. +1 214 969 9718) or Armando F. Beteta, *Dallas*, Ernst & Young LLP (United States) at [armando.beteta@ey.com](mailto:armando.beteta@ey.com) (Tel. +1 214 969 8596).

# United States

## US Customs incorporates statistical sampling and payment offsetting in audit and prior disclosure procedures



US Customs and Border Protection (CBP) has amended its regulations with regard to audit and prior disclosure procedures to incorporate the use of statistical sampling and offsetting of duty overpayments/underpayments in calculating the loss of duties or revenue (76 FR 65953, 25 October 2011). The final rule, effective 27 December 2011, formalizes CBP's current practice and does not materially differ from the initial proposed rule, published in 2009 (74 FR 53964, 21 October 2009), which we discussed in the December 2009 issue of *TradeWatch*.

We provide below an overview of the new audit and prior disclosure procedures, including some of the clarifications the final rule makes with respect to the 2009 proposed rule.

### Use of sampling methods

Statistical sampling is a method whereby the results of the sampling are relied upon to reach conclusions regarding the complete universe (e.g., an importer's customs entries for an entire year or other time period). CBP has turned to statistical sampling methods as an alternative to a 100% transaction review in order to more efficiently conduct reviews in the context of customs audits, self-testing related to customs audits and prior disclosures.

### Customs audits

The regulations clearly state that CBP auditors have sole discretion in determining the time period and scope of the audit as well as whether or not to use a statistical sampling method in lieu of conducting a 100% transaction review. The sampling plan must be prepared under generally recognized sampling procedures and be executed according to the plan.

The regulations do not go into specifics with respect to what statistical sampling factors and parameters will be used by CBP in audits. CBP has indicated that basic guidelines are already currently provided as part of the Focused Assessment (Audit) Program, and that more general guidance on statistical sampling will be forthcoming in an *Informed Compliance* publication. Even so, CBP emphasizes that specific sampling

parameters and techniques will vary depending on the circumstances. CBP auditors will use their professional judgment to apply appropriate sampling techniques on a case-by-case basis.

Once the sampling plan is defined and accepted, the audited entity waives (in writing) the ability to contest the validity of the sampling plan or its methodology at a later date, except that areas, such as computational and clerical errors in the sampling, may be challenged. At the same time, CBP's authority to conduct the audit or to employ sampling (or even to change the methodology during the course of the audit) is not dependent on the audited entity's acceptance of the specifics of the sampling plan.

CBP has clarified that the audited entity would be waiving only its ability to contest the sampling and methodology employed in the audit. The audited entity would not be waiving its ability to raise substantive objections it may have concerning the audit's underlying findings.

### Self-testing

The amendments provide that importers subject to an audit may – upon CBP approval – conduct self-testing under CBP supervision. In this case, importers are able to work with CBP in determining the appropriate sampling plan. Further, it is the importer that conducts the analysis and testing. While the audited entity is required to expressly waive the ability to contest the validity of the sampling plan or its methodology at a later date, CBP has retained some discretion as to whether or not to accept the results.

### Prior disclosure

CBP's amendments also allow statistical sampling in the context of prior disclosures. The final rule adds the requirement that the prior disclosure include an explanation of the sampling plan and its methodology. The importer may propose a sampling plan, work with CBP to develop one, or explain one that it has already worked through in preparing to calculate the lost duties/revenue. The methodology must be in accordance with the new statistical sampling requirements and are subject to CBP review and approval. CBP also notes that



all such prior disclosures will be reviewed by Regulatory Audit to some extent.

As under audit and self-testing procedures, once the importer and CBP have agreed to a sampling plan and its methodology, the importer cannot contest their validity at a later date. For a prior disclosure, after CBP review, CBP will allow an importer a reasonable opportunity to resolve defects in the sampling.

## Use of payment offsetting

CBP's recent amendments also provide the ability to apply offsets of overpayments of duties or fees and over-declarations of quantities or values in calculating the loss of duties, taxes and fees or monetary penalties stemming from audit findings (including self-testing). The offsetting mechanism has had legal effect since The Trade Act of 2002.

The applicability of the offsetting provisions is limited to finally liquidated entries in the time period and scope of the audit, as defined by CBP. Offsetting can be applied whether an entry-by-entry or sampling methodology was used.

The final rule provides that CBP will also consider allowing offsetting in the context of a prior disclosure, even if submitted outside the context of an audit. CBP notes that all prior disclosures involving offsetting will be referred to Regulatory Audit for review and approval.

## Implications for importers

As previously mentioned, statistical sampling has been used in practice in the context of customs audits, self-testing and prior disclosures for some time. However, the new rule is more restrictive than today's practices considering the strict language with respect to CBP's sole discretion regarding the use and application of statistical sampling, particularly with respect to customs audits. It remains to be seen in practice what level of importer input audit teams will consider when formulating the sampling plan and process in the context of an audit. This likely will depend on the audit team and circumstances of the audit.

In the case of self-testing and prior disclosures, the importer has more opportunities to work with CBP to develop its own sampling plan. However, guidance has not been provided with respect to how CBP will determine, under the new framework, whether or not to accept or deny a particular set of sampling results and if a denial will be issued, whether or not the audited entity will be afforded an opportunity to correct any deficiencies. Because CBP has a significant amount of discretion during the process, including options to reject the importer's results or to review transactions that are not included in the statistical sampling plan, importers have a risk when undertaking a sampling plan. As a result, importers need to be especially diligent with their role in defining and executing any statistical sampling plan to prevent lengthy or additional review by CBP.

The provisions for payment offsetting can be advantageous for importers and used proactively to help reduce any additional duty liability. At the same time, importers must understand that offsetting may lead to additional customs scrutiny, particularly with respect to prior disclosures.

Importers should keep in mind that these provisions are intended to expedite customs audits. As a result of the time savings, CBP may be able to actually increase its audit activity. Accordingly, it is important that importers are educated on the new statistical sampling techniques and methodology used by CBP auditors and the offsetting provisions. Each provision has advantages and disadvantages for importers. By understanding the regulations, importers can determine whether a favorable or unfavorable result will apply to their specific circumstances.

---

For additional information, contact Michael Leightman, *Houston*, Ernst & Young LLP (United States) at michael.leightman@ey.com (Tel. +1 713 750 1335) or Bob Schadt, *Washington, D.C.*, Ernst & Young LLP (United States) at robert.schadt@ey.com (Tel. +1 202 327 7743).

# US Customs considers changing the impact of post-importation transfer pricing adjustments



In a significant development for customs valuation and transfer pricing in the US, CBP is considering a change regarding the impact of post-importation price adjustments on transaction value. On 23 September 2011, CBP posted a notice regarding this matter on its website requesting public comments. The comment period has ended and now the trade anxiously awaits the final outcome of what would be welcomed guidance for companies with retroactive transfer pricing adjustments.

## Background

Many importations into the United States involve related-party transactions, which require that the transfer price meets the arm's-length standard for income tax purposes. These transactions often involve formal intercompany agreements that call for adjustments to be made to the transfer price after importation. These agreements have raised the issue of whether transaction value<sup>2</sup> is the proper basis for customs valuation in circumstances where a post-importation adjustment has been made.

In a deviation from its past position, CBP is proposing that even though the parties are related and certain costs may be within the control of the parties, if the transfer pricing policy is set before importation, the transfer pricing policy may be considered an objective formula, allowing the use of transaction value. Moreover, when prices are adjusted downward pursuant to the transfer pricing policy, CBP is considering that these adjustments may allow importers to obtain a refund of previously overpaid customs duties. Previously, CBP has often considered a decrease in the transfer price to be a post-importation rebate or decrease, which is disregarded for customs purposes.

In the past, CBP has allowed some adjustments, but not under the transaction value method. CBP had determined that transaction value did not apply because the price was not considered to be fixed or determinable pursuant to an objective formula prior to importation because at least one of the elements for determining the price was within the control of the buyer and/or the seller. Adjustments made pursuant to other methods of customs valuation have proven difficult to manage and apply.

CBP notes that as with any other transaction, companies must be prepared to demonstrate that the transaction value is arm's-length based on customs regulations. Also under the proposed new policy, for companies to claim post-importations adjustments under transaction value, CBP is contemplating that importers must use the US Customs Reconciliation Program to properly apply adjustments (under this program, adjustments can be filed up to 21 months from the customs entry summary date).

## Implications

While the change in position is welcome news, our initial assessment of the proposal is that the criteria proposed by CBP for evaluating adjustments is unnecessarily complex, and should be streamlined. Ernst & Young LLP has submitted comments on the proposed policy suggesting more concise criteria, which we believe would be beneficial for both importers and CBP. We will report on developments in future editions of *TradeWatch*.

---

For additional information, contact Bob Schadt, *Washington, D.C.*, Ernst & Young LLP (United States) at robert.schadt@ey.com (Tel. +1 202 327 7743) or Bill Methenitis, *Dallas*, Ernst & Young LLP at william.methenitis@ey.com (Tel. +1 214 969 8585).

---

<sup>2</sup>Transaction value is the preferred method of customs valuation. Recent estimates are that it is used by approximately 86% of importers (USITC Dec. 2009 Report - "Use of the First Sale Rule for Customs Valuation of US Imports").

# Renewal of the US Generalized System of Preferences



On 21 October 2011, President Obama signed House Resolution 2832 (now P.L. 112-40) into law. Among other provisions, the law renews the Generalized System of Preferences (GSP) through 31 July 2013. As a result, since 5 November 2011, importers have been able to claim preferential treatment normally by using the GSP Special Program Indicators (SPI), A, A\* or A+ on entry documents.

Importantly, similar to prior GSP expirations, the law extends the program retroactively to its expiration date (i.e., on 31 December 2010). Accordingly, duties paid on qualifying goods that entered the United States during the GSP lapse of nearly 10 months may be refunded pursuant to specific procedures.

## Duty refund process

CBP issued guidance (CSMS #11-000266) to explain the procedures for obtaining refunds for duties paid on GSP eligible shipments entered from 1 January 2011 through 4 November 2011.

For shipments filed through CBP's automated broker interface using the appropriate SPI, CBP will automatically issue refunds on eligible entries. CBP began processing these refunds shortly after the bill's signing, and estimates that refunds will be issued in approximately 10-12 weeks.

For automated commercial environment entry summaries processed without the appropriate SPI, refunds may be obtained via post-summary correction (PSC) as long as the time requirements for PSC filing have not expired.

Importers can obtain refunds for all other entry summaries (e.g., warehouse withdrawals, change liquidations, re-liquidations and suspended entry summaries) by following normal liquidation or re-liquidation procedures. Claims must be filed with CBP no later than 180 days after the date of the GSP enactment and may be made via post-entry amendment or protest. The claims must contain sufficient information to enable CBP to locate the entry (i.e., entry number, line number, requested refund amount, etc.) All refunds will be paid, without interest, not later than 90 days after the date of liquidation or re-liquidation.

## 2011 Annual Review process

The 2011 Annual Review process began on 1 November 2011. This process allows interested parties to submit petitions to the United States Trade Representative (USTR) to consider modifications to the list of products eligible for GSP preferential tariff treatment. GSP benefits are removed when exports are deemed competitive. Additionally, the review process considers eligibility for beneficiary developing countries (BDC) designation based on country practices (e.g., labor issues).

The extended lapse of the GSP program led the USTR to dismiss of all the petitions submitted for the 2010 Annual Review, except for consideration of BDC status for the Republic of Georgia (76 FR 67531, 1 November 2011). Accordingly, there are no major changes to report at this time, except that the USTR has initiated a review to consider the possible addition of the Republic of South Sudan as a BDC (76 FR 69319, 8 November 2011).

## Economic impact

GSP continues to be an important customs program that offers significant benefits for businesses. The program currently provides preferential duty-free entry for approximately 4,800 products from 131 BDCs. Per the USTR, importers saved USD 682 million in duties from 2010 GSP claims, and CBP is expected to refund hundreds of millions of dollars through the program's retroactive extension. At least until 31 July 2013, businesses have certainty that GSP benefits will be available for qualifying products.

Given the recent renewal and the potentially large refunds at stake (along with the cash flow effects) due to the relatively long expiration period, it is important that affected companies carefully comply with the refund procedures and monitor the collection of refund payments.

---

For additional information, contact Adam Holland, *Chicago*, Ernst & Young LLP at adam.holland@ey.com (Tel. +1 312 879 4433) or Sean Barni, *San Jose*, Ernst & Young LLP at sean.barni@ey.com (Tel. +1 408 947 5473).

# Merchandise processing fee increased, but for how long?



Effective 1 October 2011, the merchandise processing fee (MPF), a US customs user fee applied on a per shipment basis for imports, increased to 0.3464% from 0.21%. This change was established in the same law that renewed the GSP program and mirrored in the recently signed KORUS implementing bill (P.L. 112-41). However, the two laws contain contradictory language regarding when future MPF rate changes will occur.

The GSP law directs that the rate remain at 0.3464% until 1 December 2015, when it would drop back to 0.21% through 30 September 2016, and then drop further to 0.1730% for the period 1 October 2016 through 30 September 2019. By contrast, the KORUS provision directs that the rate remain at 0.3464% through 30 June 2021. Neither law modifies the USD 485 MPF ceiling or USD 25 floor for formal entries.

Because the KORUS legislation was signed subsequent to the GSP legislation, it is expected that the provision in the KORUS law will supersede the provision in the GSP law. CBP has not yet issued its formal position.

For now, the MPF increase will negatively impact many importers – particularly importers that file multiple entries each week and whose MPF payments do not encounter the USD 485 per entry ceiling. Importers that are materially affected may consider MPF-saving strategies, such as weekly-entry procedures available through foreign trade zone operations as discussed in the article *The proposed customs fee could make US foreign-trade zones even more attractive* from the September 2011 issue of *TradeWatch*.

---

For additional information, contact Adam Holland, *Chicago*, Ernst & Young LLP at [adam.holland@ey.com](mailto:adam.holland@ey.com) (Tel. +1 312 879 4433) or Sean Barni, *San Jose*, Ernst & Young LLP at [sean.barni@ey.com](mailto:sean.barni@ey.com) (Tel. +1 408 947 5473).

## Australia

### Australian Tribunal decision opens the door for importers seeking tariff concessions



A recent Australian Tribunal decision has increased opportunities for duty-free importation where there is a demonstrable lack of domestic industry.

Importers of goods into Australia can apply for a tariff concession order (TCO) that allows duty-free entry of specified goods when there are no substitutable goods produced in Australia in the ordinary course of business. A recent decision by the Administrative Appeals Tribunal (Tribunal) points to a possible relaxation of the strict rules regarding when a concession will be granted.

The tariff concession applies to all goods that fit within the terms of the particular TCO and can be accessed by any importer (i.e., not only the applicant of the concession). In determining whether a TCO will be granted, disputes often arise as to whether the goods described in the TCO and the locally produced goods are “substitutable.” The test of substitutability is based on a comparison of the uses of the relevant goods.

#### Substitutable goods – strict approach

Traditionally, Australian courts and tribunals have focused exclusively on the corresponding uses of the relevant goods and not the manner in which those uses are performed or other commercial considerations. For example, portable heaters have been found to be substitutable for wall-mounted heaters, as both goods have the use of domestic heating.

In considering substitutability, courts and tribunals have looked at all goods potentially covered by the TCO (rather than simply the goods intended to be imported) and have held that the following three factors are irrelevant:

1. The method by which the respective goods perform their corresponding use
2. The difference in price, efficiency or quality of the respective goods
3. Whether the respective goods compete in the same market

It has also been held that it is only necessary to have one corresponding use, and, if that can be shown, it will not matter that there are other uses of the goods which do not correspond. For instance, a basic mobile phone with the one use of making telephone calls would be substitutable for a smart phone with many possible uses.

This strict approach has made it difficult for importers to obtain TCOs where a local manufacturer objects to the application, even if as a matter of commercial reality the locally produced good would not be used in the place of the TCO good.

#### More commercially realistic approach

In a recent Tribunal decision (*Toyota Material Handling Australia Pty Ltd and Chief Executive Officer of Customs and Crown Equipment Pty Ltd* AATA 600 (30 August 2011), hereinafter referred to as *Toyota Material Handling*), the Tribunal took a more practical and commercially realistic approach in considering substitutability and allowed a TCO, despite accepted evidence of overlapping use.

In *Toyota Material Handling*, the Tribunal had to consider whether the Australian Customs and Border Protection Service (ACS) was correct in rejecting an application for a TCO that covered certain types of rider operated fork lift trucks described as “reach” trucks, which had a high lifting capacity. The ACS had determined that the locally produced “pedestrian” operated trucks (that did not have as high a lifting capacity) were substitutable and thus rejected the TCO application.



The Tribunal, however, set aside the decision of the ACS and granted the TCO to the importer. In determining that the locally produced goods and the imported goods were not substitutable, the Tribunal focused on the practical differences of their commercial uses and held that the locally produced goods were not substitutable for the goods described in the TCO. This is significant, as substitutability was denied even though the imported goods could undertake most, if not all, of the functions that the locally produced goods could undertake (i.e., there was an overlap in the type of work the two goods could undertake).

The Tribunal granted the tariff concession despite the overlapping uses by:

1. Confining the comparison to a representative sample of goods covered by the TCO, as opposed to all goods covered by the TCO (this excluded goods at the outer margin of the TCO where there was the greatest level of overlap)
2. Ignoring instances of overlapping use where that use was an “exception to the rule”

In adopting this approach, the Tribunal considered that it was comparing goods in a practical and commercial manner.

The local manufacturer has appealed the decision. The hearing of that appeal is likely to take place in February 2012.

## Implications for business

If the decision is upheld, it will result in a significant resetting of the test of substitutability in favor of TCO applicants. The decision would introduce arguments of commerciality and practicality into what has previously been a very narrow legal test. Confirmation of the decision would also result in the ACS having a difficult task of identifying what is a “representative range” of the TCO goods and deciding which instances of overlapping use should be ignored as an “exception to the rule.”

Importantly for importers, the decision in *Toyota Material Handling* potentially increases the likelihood of a TCO being granted even where there is a local manufacturer of similar goods. Accordingly, this development could provide new opportunities for importers to reduce customs duty costs.

---

For additional information, contact Russell Wiese, Melbourne, Ernst & Young (Australia) at [russell.wiese@au.ey.com](mailto:russell.wiese@au.ey.com) (Tel. +61 3 8650 7736) or Marc Bunch, Sydney, Ernst & Young (Australia) at [marc.bunch@au.ey.com](mailto:marc.bunch@au.ey.com) (Tel. +61 2 9248 5553).

# Japan

## Japan Customs sheds light on the customs treatment of retroactive transfer pricing adjustments



Many multinational companies have transfer pricing policies that involve an end-of-year transfer pricing adjustment, and the failure to reflect such payments in the customs value of affected imports is a frequently cited violation. In fact, this has consistently been raised as one of five major violations in Japan Customs's (Customs) annual report on post-entry audits, including the latest report for year ending June 2011. However, surprisingly, Customs had not previously provided formal guidance on the customs treatment of such adjustments. This lack of clarity from Customs has often created uncertainty over the proper treatment of retroactive transfer pricing adjustments, especially around the applicability of transaction value as the customs value and the eligibility for a customs duty refund when the adjustments result in a credit to the buyer.

A recent ruling from Customs in Tokyo provides welcome new direction in this area with some insight for importers on the customs implications of certain transfer pricing agreements.

### Tokyo Customs ruling

The Tokyo Customs ruling,<sup>3</sup> issued on 9 March 2011 (but only recently made publicly available) involves the sales of prepared foodstuffs from a foreign manufacturing company to its related company in Japan. The purchase agreement for the sales transaction between the parties stipulated that the price for the merchandise shall be the price adjusted in accordance with the Advanced Price Agreement (APA), which the parties obtained from the tax authorities in Japan and the foreign country.

According to the APA, in order to bring its operating profit margin within an acceptable range, adjustment to the transfer price will be made at the end of the financial year if the importer's operating profit margin falls outside of the pre-determined range for that year. An adjustment will also be made at the end of the seventh year if the cumulative operating profit for the seven years falls outside of the pre-determined range. These transfer pricing adjustments are for the imported goods, and the adjustments will be reflected across the board to all goods imported in that financial year.

In its ruling, Customs ruled as follows:

- ▶ The adjustments construe a part of the price actually paid or payable since (1) the purchase contract indicates that the transfer price for the imported goods will be adjusted in accordance with the terms of the APA, which calls for an adjustment at the end of each financial year and at the end of the seventh year and (2) the importer concedes that such adjustment is for the imported goods.
- ▶ Because the adjustment is made after importation, the value declared at the time of import should be amended by filing an amended return after the price is finalized.
- ▶ However, because the price of goods imported in the initial year is not finalized until after the seventh year-end, the price is not fixed within the time frame in which an amended return can be filed.
- ▶ Accordingly, the sale is "subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued," and therefore, customs value cannot be determined based on transaction value, and should be determined by an alternative method.

<sup>3</sup><http://www.customs.go.jp/zeikan/seido/kanzeihyouka/H23jirei/230309.pdf>



With respect to amendments, we note that under Japan Customs law, where the declared value was undervalued, an importer has three years from the date of the import permit to file an amended return, provided that Customs was not already aware of the undervaluation. Where the declared value was overvalued, an importer has one year from the date of the import permit to file a request for correction. A tax reform proposal currently pending in the Diet (parliament) will extend both prescription periods to five years.

## Implications for importers

From this ruling, it may be said that a transfer pricing adjustment does not preclude the use of transaction value provided that:

- ▶ The purchase contract clearly states that the transfer price will be adjusted at the end of a specified term (quarter, year, etc.)
- ▶ The final adjusted transfer price is available within the period during which an amended return can be filed
- ▶ The importer files an amended return after the adjustment

Moreover, importers who are involved in related-party transactions subject to transfer price adjustments should be aware that transfer pricing is very much relevant for customs purposes. Some important guidance from the Tokyo Customs ruling includes:

- ▶ Where the final price is determined within the period in which an amended return may be filed, the adjustment would require the filing of an amended return.
- ▶ Where the final price is determined after the period in which an amended return may be filed, the customs value should be determined based on alternative methods, i.e., transaction value of identical or similar goods, deductive value method, computed value method and fall-back method.

It is important to note that a failure to file the amended return or inappropriately basing the import declaration on transaction value could lead to penalties of 10% to 15% assessed on the under-declared value plus interest.

With the publication of this ruling, importers should expect Customs to more closely scrutinize transfer pricing adjustments and transfer pricing policies in post-entry audits. Therefore, importers involved in related-party transactions should review their existing transfer pricing policies, valuation methodologies and import declaration processes to prepare in advance for any potential customs scrutiny on the matter.

---

For additional information, contact Yoichi Ohira, *Tokyo*, Ernst & Young Shinnihon Tax (Japan) at [yoichi.ohira@jp.ey.com](mailto:yoichi.ohira@jp.ey.com) (Tel. +81 3 3506 2678).

# New protocol strengthens the Japan – Mexico economic partnership agreement



The protocol amending the agreement between Japan and the United Mexican States (Mexico) for the Strengthening of the Economic Partnership (JMEPA) was signed on 23 September 2011. The new protocol aims to enhance liberalization of trade between the two countries through improvements in market access conditions related to trade in goods and relaxation in the origin certification procedures. The protocol is expected to become effective on the 30th day after the parties exchange notes on the completion of necessary legal procedures for the entry into force in the respective countries.

The main topics of the protocol are as follows:

1. Improvement of market access conditions related to trade in goods:
  - a) Mexican side
    - ▶ Elimination of tariffs imposed on certain auto parts and paper for ink-jet printers on 1 April 2012, two years earlier than the original schedule, as well as the elimination of tariffs on mandarin oranges
    - ▶ Establishment of tariff rate quotas for apples and green tea
  - b) Japanese side
    - ▶ Expansion of tariff rate quotas and reductions of in-quota tariffs applied to beef, pork, chicken, oranges and orange juice
    - ▶ Establishment of a tariff rate quota for agave syrup
2. Creation of a provision clarifying that most-favored nation (MFN) applied tariff rates under the WTO will apply to goods when the MFN rates are lower than the corresponding tariff rates under the JMEPA
3. Introduction of the Approved Exporter System whereby an approved exporter will be able to export eligible goods by self declaration, i.e., without having to obtain origin certificates

In effect, the protocol has reinforced the merits of utilizing JMEPA, especially for companies in the automotive industry and manufacturers of printing papers. Companies with trade flows between Japan and Mexico should review the protocol provisions and determine whether additional benefits from the liberalization could apply to their operations.

---

For additional information, contact Yoichi Ohira, *Tokyo*, Ernst & Young Shinnihon Tax (Japan) at [yoichi.ohira@jp.ey.com](mailto:yoichi.ohira@jp.ey.com) (Tel. +81 3 3506 2678).

## Turkey

### Turkey implements new settlement practice for customs disputes



In Turkey, taxpayers can now take advantage of the new settlement practice for customs disputes. Under the settlement practice, the taxpayer and customs authority hold reconciliation meetings in an attempt to resolve disputes involving taxes accrued in the scope of the customs legislation and related penalties. As an alternative to the general procedures, which limited the taxpayer's legal remedies to a judicial process involving the tax courts, the new procedure is expected to reduce settlement costs and ensure faster resolution of customs disputes.

The principles and procedures for the settlement practice were introduced by the customs settlement regulation, which was published by the Ministry of Customs and Trade in the *Official Gazette* dated 28 August 2011 and became effective on 31 August 2011. This regulation implemented Law no. 6111 on the restructuring of receivables (dated 13 February 2011), which added article 244 to Customs Law no. 4458 (Customs Law).

#### Scope

The settlement practice covers disputes involving the tax receivables assessed by the customs authority (e.g., customs duties assessed upon declaration or resulting from post-importation audit findings) as well as amounts stemming from voluntary disclosures by the taxpayer (e.g., errors identified by the taxpayer that result in additional tax and penalty assessments, which were reported prior to discovery by the customs authority). Customs taxes and related penalties that may be settled under this new procedure are not limited to customs duties, but also include value-added tax, special consumption tax, anti-dumping duties, the tobacco fund and environmental contributions, among other customs-related taxes.

Furthermore, the regulations on settlement practice do not distinguish between customs regimes; tax receivables arising from the violation of provisions on conditional exemption regimes (e.g., transit warehouse, inward processing in the scope of conditional exemption and temporary import regimes under customs control) are also allowed to benefit from these procedures. However, certain receivables are excluded from the scope of the settlement practice, such as cases involving smuggling crimes and offenses prescribed under Law no. 5607 on the prevention of smuggling.

#### Application

To initiate the settlement practice, the taxpayer must file a petition to the applicable settlement commission within the objection period as per article 242 of the Customs Law, which is 15 days from the date of the customs notification regarding the tax receivable and/or penalty. The Customs and Enforcement Directorate Settlement Commission is authorized to deal with cases involving customs receivables up to TL 500,000, while the Central Settlement Commission is authorized to handle cases exceeding TL 500,000.

Under the new regulation, each issue is taken into account separately; however, in cases where there is more than one issue in the scope of the customs declaration (e.g., tariff classification and customs valuation) or there is more than one tax receivable of the same character (e.g., multiple entries involving the same customs valuation error), the total amount shall be taken as the basis for the settlement. Accordingly, taxpayers may file a single application that covers the total amount for receivables pertaining to multiple declarations of the same character or multiple items within the same declarations. Thus, the new regulation provides an important facilitation measure that eases the administrative burden.

## Settlement meetings and agreement

There are some restrictions with respect to participants in the settlement meetings. Generally, the taxpayer must personally attend the meetings (some exceptions apply) and while a customs advisor and other individuals may attend to provide opinions, a maximum number of three individuals other than the taxpayer are allowed.

During the meetings, the taxpayer and the customs authority have the opportunity to evaluate the customs tax receivables together and negotiate a settlement. The settlement commission is authorized to make adjustments on the disputed customs tax and on any related penalty that is subject to reconciliation. The settlement commission is authorized to cancel the taxes and the penalties as well. In practice, however, we observe that the settlement commission only allows reductions in penalties.

When the taxpayer and the customs authority reach an agreement with respect to the disputed customs receivable, the agreed-upon customs tax and any related penalty amounts are formalized in the final minutes of the settlement meeting. Taxpayers must pay the customs taxes and penalties within one month upon receipt of the minutes. Importantly, we emphasize that the settlement agreement is rendered void if the customs receivables are not paid timely, in which case the customs receivables would be collected as per the general provisions (i.e., judicial process).

## Opportunity to appeal to the tax courts remains

Additionally, we emphasize that the fact that the taxpayer requested settlement and went through the settlement process does not eliminate the rights to object against the decision of the settlement commission and appeal to the tax court. In this case, the taxpayer may object to the amount of the customs taxes and penalties accrued by the customs authority, not the settlement commission decision, as per the article 242 of the Customs Law.

Timing is an important factor in this instance. As mentioned previously, taxpayers have a 15-day time frame to object and file a lawsuit. Upon requesting settlement, the clock stops, but begins again in case the parties fail to reach a settlement. For example, if the application to the settlement commission is made on the fourth day of the 15-day time frame, then an 11-day time period remains for an objection (i.e., filing of a lawsuit) should a settlement agreement not be reached.

## Implications for business

Now that the settlement practice, which has been implemented successfully for many years by the Ministry of Finance for certain income tax receivables, will be applied by the customs authority as well, it will serve as an important legal alternative for the resolution of customs disputes. The taxpayer thus has the opportunity to avoid the costly and lengthy judicial system while working with the customs authority to agree on a settlement.

---

For additional information, contact Sercan Bahadir, *Istanbul*, Kuzey Yeminli Mali Musavirlik A.S., the Turkey member firm of the global Ernst & Young network at [sercan.bahadir@tr.ey.com](mailto:sercan.bahadir@tr.ey.com) (Tel. +90 212 315 3000).



# CIS

## New CIS rules of origin now effective in Ukraine as preferential trade moves closer to free trade



### Ukraine latest CIS member to implement new origin rules

Preferential trade within the Commonwealth of Independent States (CIS) is increasingly subject to the new rules for determining the country of origin pursuant to the Agreement on the Rules of Origin in *Commonwealth of Independent States* (the Rules), approved by the Council of the Heads of Governments of the CIS on 20 November 2009. The agreement was signed by the governments of: Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Uzbekistan, Ukraine and Russia with implementation subject to ratification by each member state.

Ukraine is the latest member state that has ratified and implemented the new Rules, which became effective on 14 September 2011. The Rules became effective in Russia on 23 July 2011. The agreement has also been ratified in Azerbaijan, Kazakhstan, Kyrgyzstan and Moldova.

Generally, the framework of the Rules remains similar to the previous rules of origin, which were approved in 2000 (2000 Rules). The country of origin of a commodity should be the country where the commodity was completely manufactured or underwent sufficient processing under the established criteria.

The basic conditions for meeting the sufficient processing criterion also remained unchanged:

- ▶ A change of the commodity heading in the CIS Foreign Economic Activity Commodity Classification (FEACC or the Tariff) at the level of at least one of the first four digits as a result of the working/processing
- ▶ The fulfillment of the necessary conditions, or industrial or technological operations that are sufficient for the commodity to be deemed as originating from the country where those operations took place
- ▶ The ad valorem rule was met, i.e., when the value of the materials used reaches a fixed percentage in the price of the end product

At the same time, the new Rules provide for a number of changes that could impact the country of origin determination for certain types of goods. We highlight below some of the more significant changes.

### ***Terms and conditions of the free trade regime***

The new Rules provide that in addition to the criterion for determining the country of origin, all of the following conditions must be met for enjoying the free trade regime:

- ▶ A certificate of origin (Form ST-1) is available.
- ▶ Goods are imported under a direct contract between residents of contracting member states (direct purchase rule).
- ▶ Goods do not leave the territory of the member states (where the parties to the Agreement are established), except in cases where the goods are transported under the customs control through the territories of third countries, confirmed by the customs authorities of these third countries; in this case, the goods should remain unchanged and should not be subjected to any operations, except those intended for protecting and reloading the goods.

These conditions hold significant implications for CIS trade transactions. For instance, the free trade regime no longer applies to goods owned by an entity that is not a resident of a signatory state. Accordingly, goods processed (manufactured) in one of the CIS countries and then shipped to other CIS country through an agent (a resident of the CIS) are no longer eligible for preferential tariffs if such goods are owned by a foreign company. Additionally, the direct shipping rule now has the additional requirement of confirmation by the customs authorities of any third countries the goods were transported through. The administrative burden of this added control needs to be considered for transactions where direct shipping is not practical or possible due to geographic positions of the member states.



We note that the new Rules take into consideration certain cases when the direct contract between residents of contracting states cannot be concluded until after importation, such as subsequent sales (e.g., consignment agreements). In this case, an exporter will be indicated as the importer in the ST-1 certificate and a special note "For subsequent resale" provided. The free trade regime is granted after the conclusion of a sale agreement between the residents of the member states. Subsequent sales for goods imported for exhibitions and fairs may also benefit from the free trade regime after the conclusion of the sale agreement (between residents of member countries).

### ***Certificate of Origin (ST-1)***

The new Rules introduced amendments to the Certificate of Origin of ST-1 form, and provided for two new boxes: "origin criterion" and "quantity of goods." Moreover, the Rules broaden the list of grounds for not accepting the ST-1 Certificate for the free trade regime. For example, the customs authorities of the importing state can reject the certificate if the information provided in it does not correspond with the customs declaration or the goods cannot be identified.

### ***List of conditions and industrial and technological operations***

The new Rules expand the products subject to the list of the necessary conditions and industrial and technological operations that are sufficient for the commodity to be deemed as originating from the country where those operations took place (provided in the Appendix 1 of the Rules). For example, the list now applies to retread tires, carpets, mirrored glass, nickel, aluminum, lead, zinc, tin and tin products, saws, air compressors, vacuum cleaners, microwaves, DVD players and digital cameras.

### ***Exceptions from the Rules***

Certain CIS countries signed the agreement with reservations. For example, Kazakhstan, Kyrgyzstan and Ukraine made a proviso on the country of origin determination for raw cane sugar. These member states maintain the right to apply the sufficient processing criterion resulting in a change in at least one of the first four-digits of the tariff heading, consistent with the 2000 Rules.

Moreover, Ukraine reserved the right to apply its own rules of origin (rather than the CIS Rules) for the following products:

- ▶ HTS 8528 – monitors and projectors, not including television reception apparatus; reception apparatus for television
- ▶ HTS 8508 – vacuum cleaners
- ▶ HTS 851650000 – microwaves
- ▶ HTS 852190000 – DVD players

### ***Implications for importers***

The new Rules of origin involve some significant changes that affect product qualification for the free trade regime. It is essential that CIS traders understand the implications of these changes on supply chains. In particular, special consideration should be made for any transactions that involve foreign parties (i.e., non-CIS) or product flows that pass through third countries. Overlooking the new conditions and requirements could result in disqualification of the products from the free trade regime and thus, the loss of duty savings.

An added complexity is that the new rules do not currently apply across all CIS countries, but rather only for the member states that have completed the ratification process (i.e., Ukraine, Russia, Azerbaijan, Kazakhstan, Kyrgyzstan and Moldova). For the other CIS member states, the 2000 Rules continue to apply until ratification, with the exception of Uzbekistan, which remains subject to the 1993 rules of origin.



While compliance with the new Rules of origin can be challenging, the cost saving benefits will soon be even more significant as CIS preferential trade moves closer to free trade with the signing of the new free trade agreement.

## CIS signs new free trade agreement

On 18 October 2011, the governments of Russia, Ukraine, Belarus, Kazakhstan, Armenia, Kyrgyzstan, Moldova, and Tajikistan signed the Agreement On Creation Of The Free Trade Area in the Commonwealth of Independent States (the Agreement). Azerbaijan, Uzbekistan and Turkmenistan did not sign the Agreement, taking additional time to consider joining before the end of 2011.

The Agreement provides for the gradual cancellation of import duties, taxes and fees, which have equivalent effect and quantitative restrictions in mutual trade. It also includes provisions for the gradual cancellation of export duties; restrictions against increases in import duty rates on goods provided in the Attachment of the Agreement; and resolution of trade disputes using mechanisms and procedures adopted by the WTO. The new (2009) Rules of origin will apply to the Agreement.

Although the Agreement generally provides for the elimination of import and export duties on most categories of goods, some exceptions will apply. For instance, the parties have agreed that exceptions will apply for Ukraine with respect to sugar, spirits, oil and gas. Russia, Belarus and Kazakhstan established import duty on sugar originated from Ukraine at the rate of USD 340 per ton. Moldova established import duty at the rate of 75% on Ukrainian sugar until 1 January 2015. Ukraine also introduced export duty at the rate of 21% on steel and non-ferrous metals from all CIS countries. A complete schedule of the exceptions to the free trade regime and the terms of a stage-by-stage cancellation of such exceptions will be forthcoming.

The Agreement will certainly have an impact on CIS trade with new growth opportunities for business as preferential trade moves toward free trade. Prior to becoming effective, the FTA must first be ratified by the parliaments of participating countries. The Ukrainian government has already passed the bill initiating the ratification process on 9 November 2011.

Watch for further developments in future issues of *TradeWatch*.

---

For additional information, contact Eduard Zlydennyi, Kiev, Ernst & Young LLC (Ukraine) at [eduard.zlydennyi@ua.ey.com](mailto:eduard.zlydennyi@ua.ey.com) (Tel. +380 44 490 3000, ext. 8423) and Oleksii Manuilov, New York, Ernst & Young LLP (United States) at [oleksii.manuilov@ey.com](mailto:oleksii.manuilov@ey.com) (Tel. +1 212 773 5263).

# Ukraine

## Ukraine adopts new Customs Code



The Verkhovna Rada (Parliament) has adopted the draft *Law On Amendments to the Customs Code of Ukraine and Certain Other Legislative Acts of Ukraine* (Registration No. 8130-A). The Law sets forth a new version of the Customs Code.

The amendments to the Customs Code aim to bring national legislation in line with international law and into compliance with Ukraine's international obligations. These include provisions of the Istanbul and Kyoto Conventions as well as the intention to harmonize and develop a range of customs formalities.

The following novelties provided in the new Customs Code are worth noting:

- ▶ Possibility to perform customs clearance of goods at any Ukraine customs office (regardless of the company's place of registration)
- ▶ Tough time frames for customs clearance of goods (not longer than four hours)
- ▶ Possibility to use a preliminary declaration to perform certain customs procedures (in particular, control over delivery of goods to the destination customs authority; placement of goods under temporary storage)
- ▶ Possibility to declare goods before their actual importation into Ukraine or before delivery to the destination customs authority

- ▶ Declarants are released from liability for minor non-intentional mistakes
- ▶ Possibility to accept the customs value of goods based on transaction value (i.e., the primary method) automatically for commodities exempted from import duties and taxes payable upon importation; post-importation controls of the such declared values can be performed only if the customs value was determined based on transaction value
- ▶ Development of post-importation audit regulations, which have been brought in line with the requirements under the Tax Code of Ukraine
- ▶ Defined requirements for the authorized economic operator

If the President of Ukraine signs the law, the new Customs Code will come into force on 1 January 2012, except for several clauses devoted to the peculiarities of electronic information exchange. Watch for more developments in future issues of *TradeWatch*.

---

For additional information, contact Eduard Zlydennyy, Kiev, Ernst & Young LLC (Ukraine) at [eduard.zlydennyy@ua.ey.com](mailto:eduard.zlydennyy@ua.ey.com) (Tel. +380 44 490 3000, ext. 8423) and Oleksii Manuilov, New York, Ernst & Young LLP (United States) at [oleksii.manuilov@ey.com](mailto:oleksii.manuilov@ey.com) (Tel. +1 212 773 5263).

# Ukraine cancels export duties on grain



Ukraine's controversial export duties on grain are coming to an end. On 20 October 2011, the President of Ukraine signed the Law on the cancellation of duties established for the export of wheat and corn; however, export duty for barley remains in place.

As background, Ukraine introduced the following export duties for the period from 1 July 2011 to 1 January 2012:

- ▶ Wheat, at the rate of 9%, but not less than EUR17 per ton
- ▶ Corn, at the rate 12%, but not less than EUR 20 per ton
- ▶ Barley, at the rate of 14%, but not less than EUR 23 per ton

During this period, Ukraine lost its leading position for grain exports to the Middle East markets and Turkey. In effect, the export duties further disadvantaged Ukrainian exports in terms of price competition, particularly with respect to Russian wheat exporters, which benefit from an automatic VAT rebate, and Kazakhstan exporters, which benefit from government subsidies that cover transportation costs to Ukrainian and Russian ports. Overall, the implementation of export duties on grains served costly for agrarians, which suffered financial losses as well as the Ukrainian economy.

The cancellation of existing duties on grain exports is welcome news and a step forward for the liberalization of the grain market. This decision gives way to the implementation of free market principles in conformity with Ukraine's obligations as a WTO member.

It is worth noting that the original version of the Law provided only a decrease in the export duty rates on grains to a 3% level, and the introduction of duties for exports of soy beans, oilseed rape and sunflower oil at the rate of 3%. However, parliamentarians stressed the negative impact to grain market during the dutiable period and abandoned proposals for new export duties introduction.

---

For additional information, contact Eduard Zlydenny, *Kiev*, Ernst & Young LLC (Ukraine) at [eduard.zlydenny@ua.ey.com](mailto:eduard.zlydenny@ua.ey.com) (Tel. +380 44 490 3000, ext. 8423) and Oleksii Manuilov, *New York*, Ernst & Young LLP (United States) at [oleksii.manuilov@ey.com](mailto:oleksii.manuilov@ey.com) (Tel. +1 212 773 5263).

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com).

**Customs and International Trade (CIT)**

About Ernst & Young's Customs and International Trade practices.

We bring you a global perspective on customs and international trade. Our CIT professionals can help you develop strategies to manage your costs, speed your supply chain and reduce the risks of international trade. We can help to increase trade compliance, improve import and export operations, reduce customs and excise duties and enhance supply chain security. We help you to address the challenges of doing business in today's global environment to help your business achieve its potential. It's how Ernst & Young makes a difference.

*TradeWatch* is a quarterly newsletter prepared by Ernst & Young's CIT group. For additional information, please contact your local CIT professional.

© 2011 EYGM Limited.  
All Rights Reserved.

EYG no. YY2607  
1112-1312148

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

**Americas**

Bill Methenitis, Dallas  
Ernst & Young LLP  
+1 214 969 8585  
[william.methenitis@ey.com](mailto:william.methenitis@ey.com)

**Asia Pacific**

Robert Smith, Shanghai  
Ernst & Young (China) Advisory Limited  
+8621 2228 2328  
[robert.smith@cn.ey.com](mailto:robert.smith@cn.ey.com)

**Europe, Middle East and Africa**

Neil Byrne, Dublin  
Ernst & Young (Ireland)  
+353 1 221 2370  
[neil.byrne@ie.ey.com](mailto:neil.byrne@ie.ey.com)

---

**TradeWatch Editor**

Shelley Lugon-Moulin, Zürich  
Ernst & Young LLP  
+41 79 916 1435  
[shelley.lugonmoulin@ey.com](mailto:shelley.lugonmoulin@ey.com)