

TradeWatch



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Updates to processing trade operations in China



Processing trade is an inbound processing relief program that allows businesses in China to import raw materials or parts on a bonded basis for re-export production purposes. The program has been widely utilized by multinational companies to benefit their export production operations in the country. However, the complex administrative process required by Customs in managing processing trade has posed significant challenges and compliance burdens to businesses benefiting from this program.

Recently, there have been numerous changes and updates to the Customs rules and regulations, which follow the direction from the Chinese Central Government, to simplify the administration and delegate more authority to the business or local level officials. We note that the content of these regulatory updates are relevant to processing trade operations, such as:

- ▶ Decision of the State Council on Cancellation and Decentralization of a Batch of Administration Examination and Approval Items (Guo Fa [2013] No. 44)
- ▶ Measures of the Customs of China for the Supervision and Administration of Processing Trade Goods (Order of the GAC No. 219)
- ▶ China Customs Valuation Measures for Determining the Dutiable Value of Bonded Goods for Domestic Sale (Decree 211)
- ▶ Notice regarding the abolishment of certain regulations (GAC Decree No. 216)
- ▶ Decision of the General Administration of Customs on Revising Certain Regulations (GAC Decree No. 218)
- ▶ Notice regarding the implementation of supervision of processing trade goods in China (GAC Announcement No. 21)

With the changes above, Customs has reformed numerous aspects of the processing trade program, especially in the following areas:

- ▶ Valuation of goods under the processing trade program
- ▶ Simplified procedures for setting up the customs handbook

- ▶ Prior approval for outsourcing no longer required although post-registration becomes a new requirement
- ▶ Removal of the approval requirement for the customs handbook balance transfer
- ▶ Disposal procedures for treatment of scrap and defective materials simplified and streamlined
- ▶ Definition for the “separate management” of bonded materials included to ease the burden on businesses
- ▶ Flexibility permitted in cases where the physical separation of goods is not feasible
- ▶ More detailed guidelines included for the interchangeable usage of bonded and non-bonded materials

While the purpose of these changes is to simplify the administrative procedures and reduce the compliance burdens of the processing trade program, it is unclear at this point in time how these changes will be implemented in practice. As a result, it will take time for businesses to see the effects to their actual operations.

In addition to the changes above, we expect Customs to introduce even more changes to the processing trade program in the future. For example, we understand that Customs may consider issuing new rules for determining the unit consumption ratio, which is a very important aspect of the processing trade program. Watch for further updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young (China) Advisory Limited

Robert Smith, *Shanghai*
+86 21 2228 2328
robert.smith@cn.ey.com

Bryan Tang, *Shanghai*
+86 21 2228 2294
bryan.tang@cn.ey.com

Brazil

'Single window' for Brazil's Foreign Trade Program



Among the economic and tax measures recently adopted under "Plan Brazil Bigger" (*Plano Brasil Maior*), the Brazilian Government launched its single window program for foreign trade transactions (*Portal Único de Comércio Exterior*). The program aims to unify all systems used in Brazilian foreign trade transactions and simplify the importation and exportation of goods.

The tool will allow companies to submit all information to federal tax authorities in electronic format, allowing all departments of the government involved with foreign trade to access the information through the system, thus diminishing paperwork and bureaucracy. In addition to the reduction of costs, it is also expected to reduce customs clearance times from 13 to 8 days for export and from 17 to 10 days for imports.

The implementation of the system will be progressive. The first system to be implemented will be the "*Siscomex Portal*," under which companies will be able to keep track of the steps of their trade operations as well as consult the status for the export register, import licenses and export and import declarations. It is estimated that the system will be fully functional in 2017.

For additional information, contact:

Ernst & Young Serviços Tributários S.P. Ltda.

Frank de Meijer, *São Paulo*
+ 55 11 2573 3413
frank-de.meijer@br.ey.com

Gabriel Martins, *São Paulo*
+ 55 11 2573 4213
gabriel.martins@br.ey.com

Carla Matayoshi, *São Paulo*
+ 55 11 2573 5360
carla.matayoshi@br.ey.com

Simplification measures for the drawback customs regime



The Brazilian Government has recently announced two measures that aim to simplify the use of the drawback customs regime. It is expected that these measures will reduce costs and risks to the companies that operate under the regime, thereby making the regime more attractive and enhancing the export of locally manufactured goods.

The first measure is the implementation of the electronic system for the drawback exemption modality. The drawback exemption modality provides for the exemption of duties and taxes on the replacement of the stock of raw material used in the manufacture of exported goods on previous transactions.

Up to the present time, the drawback exemption modality was still controlled through paper forms and physical documentation. The implementation of the electronic system aims to simplify and reduce costs of the regime, which, according to the government, was responsible for exports of US\$8b, last year. The system is expected to be launched in the second half of 2014.

The second measure intends to regulate a very controversial matter related to the management of other drawback modalities, which is the concept of fungibility of the stock. Currently, many companies operating under the drawback suspension modality are obligated to physically segregate their raw material stock in order to not mix the material that was purchased under the regime with the material purchased outside the regime.

Since segregating the stock physically can generate very high operational costs, not to mention the risks of penalties and fines in case of mistakes in the process, companies have been requesting that the government provide some flexibility that would allow those products with the same characteristics in terms of quality and quantity to be interchangeable without harming the regime.

The Ministry of Development, Industry and Foreign Trade and the Brazilian Federal Revenue are currently reviewing this issue and considering a regulation that would address the current restrictions of the application of the fungibility concept to provide some relief under certain conditions. Watch for further developments in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young Serviços Tributários S.P. Ltda.

Frank de Meijer, *São Paulo*
+ 55 11 2573 3413
frank-de.meijer@br.ey.com

Gabriel Martins, *São Paulo*
+ 55 11 2573 4213
gabriel.martins@br.ey.com

Carla Matayoshi, *São Paulo*
+ 55 11 2573 5360
carla.matayoshi@br.ey.com

Mexico

Impact of regulatory changes affecting IMMEX companies



Mexico's Tax Reform, approved by the Mexican Congress on 31 October 2013, is having a significant impact on the IMMEX¹ program, which grants various tax and customs benefits to companies manufacturing goods for export. In light of these regulatory changes, some of which we highlight below, multinational companies with IMMEX operations may want to reassess the program's feasibility.

Tax impact – new requirements for IMMEX companies with “*maquila operations*”

From a tax perspective, IMMEX companies that perform a qualified “*maquila operation*” (i.e., where the raw materials and components are owned and supplied under consignment by a foreign principal that also owns a portion of the machinery and equipment (M&E) used for manufacturing) have enjoyed tax benefits, such as a permanent establishment exemption for foreign residents, flexible transfer pricing rules and reduced income tax rates, among others. Access to these traditional tax benefits, however, are now limited as the tax reform has placed additional and more stringent requirements on companies operating under the IMMEX program.

For example, the tax reform changes make it more difficult for a foreign principal to continue benefitting from the permanent establishment exemption in Mexico as the new rules require that 100% of an IMMEX company's “productive income” is derived from the *maquila* operation. This requirement goes into effect on 1 July 2014. As a result, non-*maquila*-related income should not be earned by the IMMEX company. For instance, buy/sell activities by the Mexican IMMEX entity could cause the foreign principal to fail the permanent establishment exemption requirement. Other activities, such as services, leasing, etc. need to be analyzed on a case-by-case basis.

Customs impact – payment of VAT on temporary importations

From a customs perspective, the IMMEX program allows for the temporary importation of materials, components and M&E used for the manufacture of finished goods for subsequent export. The tax reform has limited the temporary importation regime by removing the value-added tax (VAT) exemption from 1 January 2015.

While the VAT (at a general rate of 16%) payable upon importation may be recovered through a credit or refund when the finished goods incorporating the temporarily imported goods are exported or transferred via “virtual” operations, the recovery process generally takes significant time and effort and is usually surrounded by a high level of uncertainty regarding the timing of the recovery.

As an alternative to reduce the negative cash flow impact that the VAT amendments could have on the IMMEX industry, the Mexican tax authorities established a VAT certification process, which allows IMMEX companies to apply a tax credit against the VAT that has to be paid for the temporary importation of goods.

The VAT certification registration process is complex and, among other obligations, requires that companies:

- ▶ Demonstrate that their inventory control system is up-to-date
- ▶ Allow access to Mexican customs administration personnel for an initial on-site inspection
- ▶ Allow on-going access for on-site inspections to verify that the company continues to meet certification requirements

¹ A program authorized by the Mexican Ministry of Economy under the Decree for the Promotion of the Manufacturing, Maquiladora and Export Services Industries.



Where the customs authorities identify any issues (e.g., that temporarily imported goods have not been returned abroad or have been subject to a change of regime from temporary to permanent within the prescribed time limits), they could cancel the company's VAT certification registration and potentially, the IMMEX program authorization.

If the VAT certification is cancelled, the IMMEX company will have to pay the corresponding VAT at the general 16% rate and will not be able to renew its VAT certification until 24 months after the cancellation determination has been issued.

An additional alternative for companies that do not meet the VAT certification requirements or that do not want to manage the increased audit risk is to place a bond before the customs authorities. The bond should guarantee the VAT payment for those goods that are not exported or transferred via "virtual" operations. Additional rules governing the specific bond requirements will be published shortly by the Mexican customs authorities.

See also our article in the March 2014 issue of *TradeWatch*, "New certification rules for VAT credit on temporary importations by IMMEX companies and other customs regimes."

IMMEX program feasibility

In light of these changes, it is timely for multinational companies to reassess the actual tax and customs benefits under the IMMEX program. In this regard, companies should consider a feasibility analysis in order to determine the best way to address these new regulatory changes on the IMMEX program, such as:

- ▶ Quantification of customs and tax benefits under the new rules
- ▶ Identification and quantification of alternate duty reduction options through other programs, such as the sector promotion program, known as PROSEC or free trade agreements
- ▶ Comparison of identified alternatives versus regulatory options to mitigate the VAT impact (i.e., VAT certification, bond placement)

For additional information, contact:

Ernst & Young LLP (United States)

Armando Beteta, *Dallas*
+1 214 969 8596
armando.beteta@ey.com

Ernesto Ocampo, *San Diego*
+1 858 535 7383
ernesto.ocampo@ey.com

Sergio Moreno, *Dallas*
+1 214 969 9718
sergio.moreno@ey.com

Pacific Alliance

Mexico and Panama sign free trade agreement



On 3 April 2014, Mexico and Panama signed a free trade agreement (FTA). The new agreement is not only significant for the new trade and investment opportunities between the two economies, but also because it paves the way for Panama to join the Pacific Alliance.

The Pacific Alliance trade bloc currently includes Mexico, Colombia, Chile and Peru. The Pacific Alliance aims for free trade and economic integration by facilitating the cross-border movement of originating goods, services, capital and people between member countries. The main purpose of the Pacific Alliance is to establish a deep integration area between the member countries to promote the growth, development and competitiveness of their economies, and to become a political, economic and commercial hub.

The Pacific Alliance involves the consolidation of the existing FTAs between member countries into a single instrument that contains a common tariff reduction schedule, a single set of rules of origin and the establishment of a common electronic certificate of origin, while also expanding origin "cumulation" rules. Ninety-two percent of all goods traded between the member countries enjoy duty-free treatment, which is significant as it promotes sourcing and production within the Pacific Alliance countries as companies design cost-effective supply chains.

One condition for potential applicant countries is that they have an existing FTA with all Pacific Alliance member countries. Panama only lacked a FTA with Mexico. As Panama currently participates in the Pacific Alliance as an observer, it is expected that full membership may take place shortly down the road.

For additional information, contact:

Ernst & Young LLP (United States)

Armando Beteta, *Dallas*
+1 214 969 8596
armando.beteta@ey.com

Sergio Moreno, *Dallas*
+1 214 969 9718
sergio.moreno@ey.com

United States

Managing risk: 'deemed exports' and foreign nationals employed in the US



A recent settlement agreement between the US Bureau of Industry and Security (BIS) and Intevac, Inc. (Intevac) serves as an important reminder to companies with technology controlled under the US Export Administration Regulations (EAR): don't overlook "deemed exports" when employing foreign nationals in the US.

The settlement agreement covered allegations that the company released technology controlled for national security reasons on the Commerce Control List (CCL) to a Russian national employee working at the company's US headquarters. The allegations covered four counts of unlicensed deemed exports to the foreign national employee and one count of an unlicensed export of controlled technology to the company's Chinese subsidiary. The five counts carried a maximum penalty of US\$1.25m (up to US\$250,000 per violation), but the settlement amount was mitigated to US\$115,000 based on Intevac's voluntary disclosure of the deemed export violations.

The deemed export and reexport rules of the EAR create significant complexity for companies that create, store or receive controlled technology and who hire foreign nationals to work with the technology, whether in the US or outside the US. Pursuant to 15 C.F.R. § 734.2(b)(2)(ii), a release of technology or software to a foreign national within the US is "deemed to be an export to the home country or countries of the foreign national." Therefore, if a transfer of technology or software to the foreign national's home country would require a BIS license, then a transfer of the technology or software to the foreign national while within the US also necessitates an export license from BIS. Similar concepts also apply for deemed reexports where transfers of US-origin technology or software are made within a foreign country to a foreign national employee of a third country and the technology is controlled for export to the foreign national employee's home country.

In the case of Intevac, the technology at issue was "production" or "development" information for a product used in hard disk drive manufacturing and controlled under Category 3 of the CCL, specifically 3E001. Within 3E001 of the CCL, the pertinent reasons for control are national security and missile technology. Items controlled on the CCL for national security reasons and/or missile technology reasons require a BIS license for exports to Russia.² In the settlement order, BIS alleged that Intevac released this technology, which was stored on its server in the US, "by providing the Russian national employee with a login identification code and password that enabled him to view, print and create attachments."³

As the Russian national employee was working at the company's US headquarters, the granting of access to the company's server provided the employee with means to visually inspect the controlled technology and therefore constituted a deemed export to the foreign national's home country and a violation of the EAR. While Intevac applied for an export license for these transfers to the Russian employee, the company did so after the initial "release," and according to BIS allowed ongoing access to the technology during the pendency of the license application.

Deemed export compliance a top enforcement priority

This settlement indicates renewed enforcement efforts by BIS in this area of the regulations and demonstrates BIS' resolve to issue penalties for deterrent effect, especially for companies that discover a violation and allow the violation to continue to occur pending obtaining a license. As stated by the Assistant Secretary of Commerce for Export Enforcement in the settlement press release, "deemed export compliance is a top priority" for BIS.

² See, 15 C.F.R. § 738, Supplement 1 (2013).

³ In the Matter of Intevac, Inc., United States Department of Commerce, Bureau of Industry and Security, February 19, 2014.



Managing the risk

For companies, universities and other institutions involved in controlled technology that employ foreign nationals in the US, deemed export compliance needs to be a high priority to manage the risk of export control violations. Intevac highlights some important considerations:

The importance of establishing, executing and monitoring internal controls and procedures

Intevac either didn't have or failed to execute a process to evaluate the employment, scope of responsibilities and the provision of access to systems containing controlled technology against export regulations and BIS licensing requirements. Further, once a violation was discovered, the company did not immediately remove the employee's access to the controlled data for the period until the BIS license application was approved.

Does your company have internal controls and procedures to review the hiring, reassignment and relocation of foreign national employees against the scope of their proposed work to determine whether controlled technology could be released to them (i.e., deemed export)? If yes, is your company applying these controls and procedures in practice and monitoring compliance? Do the procedures address actions to be taken where non-compliance is identified – such as immediately removing access to the employee?

The importance of access controls for systems containing controlled technology

It appears that Intevac's information systems and critical applications were not configured to allow for segregated access controls between controlled and uncontrolled technology.

Are your IT infrastructure, data storage protocols and access provisioning processes appropriately designed to restrict access based on the type of technology through data segregation and/or other attribute-based access control policies?

For companies that deal with US Munitions List Items under the International Traffic in Arms Regulations, these types of controls are all too familiar. At the same time, this settlement is an important reminder that companies that have controlled technology on the CCL, under the EAR, must also conduct licensing reviews, consider systems and application-based access controls, and prevent access to unauthorized foreign nationals to the information.

For additional information, contact:

Ernst & Young LLP (United States)

Nathan Gollaher, *Chicago*
+1 312 879 2055
nathan.gollaher@ey.com

Josh Gelula, *Chicago*
+1 312 879 3887
josh.gelula@ey.com

Australia

International retailers beware – Australia holds some customs surprises



Australian Customs has a well-earned reputation for being facilitative. However, there is one area of customs valuation where it is tougher than most: buying commissions. For industries where buying agency arrangements are common, e.g., retail, businesses should be aware of the local Australian interpretation and that a general WTO position may be insufficient.

Whether due to the high Australian dollar, 20 years of unbroken GDP growth, a second bite at selling a season's designs or just an excuse to get to the beach in January, there has been a spate of arrivals of international retailers in Australia. Long-ignored Aussie shoppers are delighted that brands such as ZARA, Topshop, H&M and Uniqlo have or are about to arrive. While these multinationals should find Australian Customs reasonable in most instances, one key exception common in the garment industry is buying commissions.

In the garment industry, it is not uncommon that overtime for certain aspects of production is outsourced. This may see the buying agent undertaking low levels of research and development. This will result in the buying commission being dutiable as the agent is providing services that should be included in the value of the goods.

Large buying agents may offer a variety of value-added services, such as arranging transport or insurance. We have previous experience of a payment a buying agent received for arranging insurance as being cause for Australian Customs to rule that the entire buying commission was dutiable.

Australia adopted the general WTO position that buying commissions are not an addition to the customs value. However, due to the historic perception that Australian importers were aggressively using buying commissions to decrease duty, the Australian Customs legislation has been drafted so as to make it extremely difficult for importers to have qualifying buying commissions. It is often the case that buying commissions that are undoubtedly duty-free in most countries will not be in Australia.

These outcomes flow from a strict legislative definition. The definition requires that the payment must be directly or indirectly made to an entity that represented the buyer in the purchase of the goods. This means the entity that receives the buying commission must actually act as the agent for the buyer in purchasing the goods. It is not enough for the buying agent to provide procurement advice, market intelligence or quality assurance services if it does not also represent the importer in the purchase of the goods.

The definition also sets out many exclusions that will prevent a commission from being a qualifying buying commission. These include:

- ▶ The buying agent cannot otherwise benefit from the import sales transaction.
- ▶ The buying agent cannot buy/sell the same class of goods as those the subject of the importation; this is regardless of whether the buying agent sells those goods to the buyer.
- ▶ Similarly, the buying agent cannot provide services whose value would be included in determining the price of the imported goods, or services of the same class as the aforementioned services.
- ▶ The buying agent cannot be associated with the supplier other than as agent of the buyer (this extends to related parties).
- ▶ The buying agent cannot transport the goods.



Due to the wide range of exclusions, importers must be vigilant in reviewing whether a buying commission remains qualifying where the role of the agent changes. Periodic review is crucial as large buying agents are increasingly taking on more diverse roles without notifying all importers; this is especially important as the Australian treatment can be impacted by the agent's dealings with other customers in other countries, not just Australia itself.

Importers are encouraged to ensure that an Australian-specific review is undertaken in respect of any buying commission. That review needs to involve questioning the buying agent as to all the activities they undertake even if those activities are not performed for the importer or in relation to Australia.

Where there is doubt, a binding ruling can be obtained from Australian Customs. Again, this position should be reviewed periodically or when the roles of the parties change.

Where it is clear that the payment will not qualify as a duty-free buying commission, the parties may wish to consider restructuring their arrangements and/or varying the payment method so that the payment does not constitute a commission (and may otherwise not be dutiable).

Buying commissions present difficult problems in Australia. It is clear that Australian distributors should not simply assume that because the commission is duty-free in other parts of the world, it will be duty-free under Australian law. There is no doubt this is an easier issue to address during the start-up phase before the procurement processes are finished, pressed and packed.

For additional information, contact:

Ernst & Young (Australia)

Marc Bunch, *Sydney*,
+61 2 9248 5553
marc.bunch@au.ey.com

Russell Wiese, *Melbourne*,
+61 3 8650 7736
russell.wiese@au.ey.com

Turkey

New bank security requirements for petroleum imports



Recent amendments to Turkey's special consumption tax (SCT) law include burdensome new bank security requirements for goods subject to the tax under List I, which covers a wide range of petroleum and solvent products. Specifically, these goods no longer benefit from the "flat rate" security, which allowed for multiple shipments under the same security. Now, each transaction (i.e., shipment) must be covered by a separate bank security. Both from a cost and administrative perspective, this change is having a significant effect on the oil industry as it applies to all goods in List I, including those entering Turkey under the transit and warehouse regimes.

The security amount for each transaction is 20% of the value of the goods plus the total customs taxes (calculated as the total of the SCT, customs duty and VAT amounts). However, pursuant to tax ruling no. 30.12.2013/22833, an exception applies to transit oil stored in bonded warehouses that are not subject to a license from the Energy Market Regulatory Authority. In this case, a fixed security in the amount of EUR2m may be provided by the warehouse keeper in addition to 10% of the total customs tax amount.

Additionally, the amendment provides different administrative treatment in terms of filings depending on whether the goods under the transit and warehouse regime are listed under List I-A or List I-B. These goods are now subject to a separate information form (known as Appendix-11), which must be filed electronically into the Revenue Administration system. Additionally, for goods in List I-B, the form must also be submitted by hard copy (i.e., paper-based) with the tax office.

The release of the guarantees will be performed by the customs authorities for goods listed in List I-A; on the other hand, for goods listed in List I-B, the tax office will perform the release transactions electronically through the Revenue Administration system.

In conclusion, these recent amendments to the SCT law are severely affecting oil shipments for practitioners of the transit and warehouse regime. Although negotiations have been conducted with the customs authority and the tax office, these agencies are not in favor of any changes to these new requirements that are designed to prevent fuel smuggling.

For additional information, contact:

Kuzey Yeminli Mali Musavirlik A.S.

Sercan Bahadir, *Istanbul*
+90 212 315 3000
sercan.bahadir@tr.ey.com

United Arab Emirates

Dubai Customs imposes stringent compliance requirements on Jebel Ali Free Zone activities



As the largest logistics and distribution hub in the United Arab Emirates (UAE), the Jebel Ali Free Zone (JAFZ) is used by many multinational businesses to support their business activities in the Middle East region. Over the last year, an increasing number of businesses have experienced customs audits arising from stringent customs compliance requirements enforced by the Dubai Customs Authority (Dubai Customs).

Dubai Customs maintains that JAFZ should be viewed as similar to a bonded customs warehouse, and that all activities within JAFZ must be declared to Dubai Customs. In this regard, Dubai Customs requires that:

- ▶ The physical location of any goods entered into JAFZ should be traceable.
- ▶ The quantity and weight of goods entered into JAFZ should equal the quantity and weight of goods exited from JAFZ.
- ▶ The value of the exits should be equal to or exceed the value of the entries.

If a JAFZ entity's entries into and out of JAFZ do not comply with the above requirements, they may be subject to a customs audit. The customs audit will require the entity to reconcile the variance between the goods it has declared into JAFZ and the goods it has declared out of JAFZ. Any irreconcilable variance may be subject to a 5% customs duty plus a 10% penalty, on the presumptive assumption that the variance reflects non-declared goods imported into the mainland UAE from JAFZ.

The application of the statute of limitation for a customs reconciliation audit is a contentious issue. The statute of limitation in the Gulf Cooperation Council (GCC) Customs Law is five years. Dubai Customs takes the position that the five-year period begins when goods are declared as exiting the JAFZ. Consequently, where Dubai Customs makes a determination that the goods have not been declared as exiting the JAFZ (i.e., that non-declared goods have been dispatched from JAFZ), the statute of limitation will not apply. In effect, the customs audit period could go back to the date when the entity under audit was established within JAFZ.

In practice, variances between a JAFZ entity's entries in and exits from JAFZ are likely to arise due to incorrect declaration of the following activities within JAFZ:

- ▶ Assembly and value additions
- ▶ Depreciation
- ▶ Scrapping consumption

The incorrect declaration of these activities seems most prevalent for businesses dealing with heavy equipment, repairs and maintenance, and assembly of goods within JAFZ. Many businesses including oilfield services companies, operations support centers and regional distribution hubs are unfamiliar with the JAFZ customs obligations and how the rules apply. Consequently, business processes, procedures and documentation retention practices are not adequate to deal with customs audits, leaving them unable to challenge assessments raised.

Entities operating in JAFZ should seek appropriate advice to prepare for and address customs audits to mitigate the risk of unexpected challenges and customs duty and penalty assessments.

For additional information, contact:

Ernst & Young (Qatar)

Finbarr Sexton, *Doha*
+974 4457 420
finbarr.sexton@qa.ey.com

Ernst & Young Middle East

Nicola Butt, *Dubai*
+971 4 701 0853
nicola.butt@ae.ey.com

East Africa Community

Single customs territory update: reduced customs costs



In this issue of *TradeWatch*, we continue our coverage of the East African Community's (EAC) transition to a single customs territory. With significant progress made and recent pilot programs proving successful, traders are already enjoying reduced customs costs. The single customs territory is premised on three primary pillars:

1. Free circulation of goods
2. Revenue management systems
3. Regional legal and institutional framework

Under the pillar of free circulation of goods, the framework covers the treatment of goods imported into and exported from the EAC, intra-EAC transfer of goods, port and border operations and trade facilitation.

Customs costs already reduced in Kenya, Uganda and Rwanda

Kenya, Uganda and Rwanda have already started implementing the single customs territory. Goods imported for consumption from outside the EAC are now cleared at the first port of entry with revenues remitted to the participating partner state.

Overall, the reports have been very positive. Whereas taxpayers importing goods destined for Rwanda and Uganda through the Mombasa port in Kenya are having a cash flow impact by paying duty earlier than before, the new system has saved them costs that were incurred for storage of the goods, which had to undergo several customs processes as the goods transited through each partner state before reaching their final destination.

For instance, before the single customs territory, goods moving from Japan through Mombasa to Uganda would need to be cleared for transit at the Mombasa port and then imported into Uganda. Now, a single customs import entry is prepared for importation without any storage fees, transit bonds or transit entries.

Kenya, Uganda and Rwanda have transitioned the implementation of the single customs territory for intra-EAC trade through product-specific pilot. These pilot programs applied to fuel products (since October 2013); neutral spirits, cement and cigarettes (since April 2014); and edible oils, milk and milk products, confectionery and steel products (since May 2014).

Again, the overall results have been positive. Taxpayers conducting intra-EAC trade have benefitted from reduced clearing time and costs as well as administrative requirements. As an example, for goods shipped from Kenya to other partner states, the customs documentation and payment of duties is conducted upfront in the destination state prior to shipment. In Kenya, there is no longer the need for lodging a customs export entry as the customs systems between the partner states are now interconnected. Only a manifest is issued to enable the goods to move through Kenya together with an electronic cargo tracking system to ensure the goods are delivered to the destination partner state.

In Kenya, Uganda and Rwanda, goods exported outside of the EAC are currently being monitored by the electronic cargo tracking system, which enables the movement of goods to be faster as no physical escorts or road blocks and spot checks are required.

In these three EAC countries, port and border operations have also been enhanced using the One Stop Border Posts, which entail the use interconnected systems (RADDex) that allow the single clearance of cargo exiting one border and entering another border. A multi-agency coordinated border management system is applied at the Mombasa port using the electronic single window, which allows different governmental agencies involved in the customs clearance and collection of taxes to clear the goods using one single platform as opposed to each agency working independently and using different individual systems.



Next steps

While Kenya, Uganda and Rwanda have made significant progress implementing the single customs territory, Tanzania and Burundi remain behind. The new customs system is expected to be fully implemented by 1 July 2014, at which point all five EAC countries will have customs officials stationed at all points of entry into the community to administer and collect revenue.

Harmonization of the legal and institutional framework remains a work in progress, which can be challenging for certain aspects of trade. For instance, the application of VAT and excise tax on intra-EAC trade is currently unclear when rates vary between partner states. As another example, warehousing, transit and temporary importation regimes (i.e., for goods transiting the EAC) will still apply, but with a regional security bond rather than an individual country bond; however, the modalities on how these regional bonds will be applied are not yet in place. Further, mutual recognition of incentives, such as the Authorized Economic Operator program has not yet been realized and certain non-tariff barriers between partner states should be removed or reduced once the legal and institutional framework is harmonized.

Overall, while significant progress has been made with promising signs of reduced costs for traders, more is yet to come as the EAC implements the single customs territory.

For additional information, contact:

Ernst & Young (Kenya)

Hadijah Nannyomo, *Nairobi*
+254 20 27 15300
hadijah.nannyomo@ke.ey.com

Growth in manufacturing sector puts focus on customs and trade



In East Africa, manufacturing and industrialization is becoming a prime mover of the economies after the agricultural sector. With numerous construction and infrastructure upgrades in progress, growth in the manufacturing sector is expected to increase, particularly for Kenya, which increasingly serves as a regional hub for East Africa and platform for expansion into other areas of Africa. As stated in EY's *Africa Attractiveness Survey 2014: executing growth*, Kenya is a top emerging hotspot for foreign direct investment along with other EAC countries, including Uganda and Tanzania.

Growth in the manufacturing sector brings increased competition and more complex supply chains to provide the more cost-effective mix of sourcing, manufacturing and supply operations that entail the cross-border movement of goods. Accordingly, customs and trade considerations become vital for manufacturing companies to support growth and reduce risk and cost.

As evidenced by our recent training events for manufacturing entities conducted by Ernst & Young (Kenya), we are seeing an increased interest in customs and trade strategies to reduce costs and mitigate the risks of cross-border trade for manufacturing operations. In this article, we have provided a broad overview of the primary customs areas that companies should consider.

Customs planning

Effective customs planning is an important strategy for companies that seek to reduce costs to gain a competitive edge or serve a particular market segment in the economy by foreign sourcing raw materials, inputs, equipment and finished goods. For instance, FTAs provide preferential tariffs for goods sourced from FTA member countries, provided that the FTA-specific rules of origin and other requirements are followed. Additionally, qualifying exports to the US and EU markets can benefit under the African Growth and Opportunity Act and the Cotonou Agreement, respectively.

Additionally, the customs rules of the East Africa Community (EAC) provide a variety of customs regimes and procedures that aim to provide cash flow savings, such as:

- ▶ Manufacturing under bond
- ▶ Export processing zones
- ▶ Tax remission for export office
- ▶ Duty remissions and duty exemptions
- ▶ Storage in bond
- ▶ Temporary importation

Customs compliance

Imported goods must comply with the customs rules and requirements. The clearing agent prepares files and lodges the single administrative document/ customs entry together with the relevant supporting documentation (e.g., commercial invoice, bill of lading). Additionally, the clearing agent computes taxes payable by establishing the customs value in accordance with the customs valuation rules (based on the WTO Valuation Agreement), tariff classification and country of origin of the imported goods.

At the same time, the company is liable for any incorrect declarations to the customs authorities made by the clearing agent on the company's behalf. For this reason, it is important that the company monitors the information reported on the customs declaration. Incomplete or inaccurate information can lead to customs clearance delays, additional tax assessments and penalties.



Post-clearance customs audits

The importance of customs compliance is further emphasized by the customs authorities' increased use of the post-clearance customs audit (as reported in the March 2014 issue of *TradeWatch*, "Customs authorities focus on post-clearance audits"). During these audits, the customs authorities review the document trail to support the customs valuation, tariff classification, quantity and country of origin reported on the customs declaration to determine whether all due taxes were paid. To mitigate any exposure to non-compliance, companies are encouraged to conduct periodic internal reviews of their customs declarations so that remedial measures can be taken prior to being discovered by the customs authorities.

Customs controversy

In the event that the customs authorities impose an additional tax assessment on the company as a result of the post-clearance customs audit, the company has the opportunity to prepare an objection to the assessment. If the objection is not resolved during the audit reconciliation meetings with the customs authorities to their satisfaction, the company can either go to court or to the tax local committee/tribunal for further consideration. This process is referred to as "controversy."

Closing thoughts

Proactively managing the customs and trade aspects of your business can provide significant competitive advantages both in terms of costs and supply chain speed. As the manufacturing sector continues to grow and develop in Kenya and the EAC, it is important that companies consider customs and trade strategies in their business operations.

For more information, contact:

Ernst & Young (Kenya)

Robert Mbaziira, *Nairobi*

+254 2027 15300

robert.mbaziira@ke.ey.com

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Americas

Bill Methenitis, Dallas
Ernst & Young LLP
+1 214 969 8585
william.methenitis@ey.com

Asia-Pacific

Robert Smith, Shanghai
Ernst & Young (China) Advisory Limited
+86 21 228 2328
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

TradeWatch Editor

Shelley Lugon-Moulin
Ernst & Young LLP
+41 79 916 1435
shelley.lugonmoulin@ey.com