TradeWatch

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The World Trade Organization (WTO) Valuation Agreement, which establishes the global framework for customs valuation, has been in place since 1979. Nevertheless, interpretations of the Valuation Agreement continue to be a very dynamic area in many jurisdictions, adding complexity to business planning. This issue spotlights three significant developments: the release of the draft EU implementing regulations, which, if adopted as currently written, would substantially restrict long-standing EU rules allowing first sale for export and the exclusion of many royalties from the value; a potentially far-reaching customs case in Canada that includes party design and development costs in the value; and a new US ruling that approves the exclusion from value for a payment made for the rights to be an exclusive distributor of a product. These customs valuation developments highlight potential pitfalls and may provide new opportunities for importers to organize their business relationships in a customs-beneficial manner.

The previous edition of TradeWatch included an article regarding Regulation no. 952/2013 laying down the Union Customs Code (UCC), which was jointly adopted by the European Parliament and the European Council. We highlighted that key issues, like customs valuation, still needed to be outlined by the European Commission (Commission) by means of delegated and implementing acts. Further to the above, the Commission has recently issued a preliminary draft of the implementing acts “in order to start consultations with Member States.” Below, we briefly discuss some of the notable items.

“First sale for export” restricted

Under the existing “first sale for export” rules, EU importers that meet certain requirements are allowed to declare the price paid in the earlier sale (i.e., the first sale) for customs purposes, resulting in a lower dutiable value and, thus, lower customs duty liability. Although the “first sale for export” strategy is not precluded by the wording of the UCC, we note that the draft implementing acts seem to put a limit on the concept: the value of the goods is to be “determined at the time of acceptance of the customs declaration on the basis of the transaction occurring immediately before the goods are declared for free circulation.”

The above wording effectively limits the “first sale for export” strategy in comparison to the current situation. Not only would this language preclude using an earlier sale when there are two sales occurring before importation into the EU, but it would also appear to restrict sales that occur within the EU from qualifying as “sales for export.” For example, if goods are stored in a bonded warehouse and/or sold multiple times within the warehouse upon release into free circulation, only the last sale will qualify for valuation purposes.

Royalties and license fees: “condition of sale” broadened

Royalties are to be added to the transaction value (i.e., customs value) of imported goods only if they are related to the goods being valued and payable as a condition of sale of those goods for export to the EU. Under the proposed implementing acts, the “condition of sale” determination has been broadened so that royalties are much more easily included in the customs value, thus increasing the tax burden of affected traders. According to the proposed implementing acts, royalties and license fees are considered to be paid as a condition of sale when any of the following conditions are met:

a) The seller or person related to the seller requires the buyer to make this payment.

b) The payment by the buyer is made to satisfy an obligation of the seller, in accordance with contractual obligations.

c) The goods cannot be sold to, or purchased by, the buyer without payment of the royalties or license fees to a licensor.
If this wording is ultimately included in the implementing acts, traders may face difficulties in arguing that a royalty payment is not a condition of sale. The above draft provision seems to be a “catchall” clause. For instance, according to the third criterion, the situation whereby the buyer, the seller and licensor are all unrelated could still imply that the royalty paid by the buyer is dutiable.

Another important change is that the current specific rules for trademark royalties have not been included in the proposed implementing acts. Under the current rules, trademark royalties can be excluded from the customs value under certain conditions. As a result, trademark royalties are, in practice, often not included in the customs value and do not attract duties. Under the proposed implementing acts, this would change and trademark royalties would be treated as any other royalty.

Authorised Economic Operator: practical standards of competence

Companies granted with the authorization for Authorised Economic Operator (AEO) for customs simplifications may benefit from certain simplifications (which are still to be specified by the Commission in delegating acts). In order to be granted with this authorization, companies have to meet certain criteria, one of which includes the “practical standards of competence or professional qualifications directly related to the activity carried out.” The criteria for granting the authorization are further specified in the draft implementing acts.

Regarding the practical standards of competence, the proposed implementing acts state “a minimum of three years’ practical experience on customs matters” or an “application of a quality standard adopted by a European standardisation body.” Further to the professional qualifications, the draft implementing acts refer to an applicant who has “undertaken training and passed an examination or, depending on the activities carried out, can present a certificate of completion, consistent with the extent of his involvement in customs activities, covering customs legislation.”

The above criterion and the modalities as outlined in the draft implementing acts make up a significant restriction for granting the authorization compared to the current situation.

Lastly

The Commission has underlined that the draft implementing acts are “intended to be used as a basis for further consultation and review with stakeholders.” Although this implies that the implementing acts are still subject to changes, we note that the implications for businesses do not seem to be positive on all points.

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In one of the most important customs cases in years, the Canadian International Trade Tribunal (CITT) has just confirmed an aggressive interpretation by the Canada Border Services Agency (CBSA) concerning additions to the transaction value for intercompany payments outside of the invoice amount or transfer price relating to design and development costs allocated to the importer.

**Skechers USA Canada Inc. vs. The President of the Canada Border Services Agency**

*Skechers USA Canada Inc. vs. The President of the Canada Border Services Agency* (AP-2012-073 (CITT) 2013) (*Skechers Canada*) involved imported footwear purchased from the taxpayer’s US affiliate. The transfer price for the goods was based on the US affiliate’s factory cost from the offshore manufacturer, plus transportation, warehousing and an amount for profit. The price included the cost of the molds and samples that the US affiliate provided to the manufacturers. The price did not include the value of the design work performed in respect of the development of unsuccessful prototypes or models. In this respect, approximately 45,000 of the 50,000 models under development never made it to the final stage, and only approximately 1,700 were imported into Canada. Also not included were the costs for general research and development (R&D) expenses of the US affiliate (e.g., salaries and overhead of research, design and development staff).

As part of the cost-sharing agreement (CSA), the taxpayer also made payments for these costs to the US affiliate as a function of the volume of import purchases, based on the taxpayer’s operating profit. The CITT held that all payments under the CSA relating to research, development and design were dutiable because they were directly related to developing and designing the particular footwear that was imported. Further there was a direct link between the payments and the imported goods as the fees were calculated based on the taxpayer’s Canadian operating profit. Hence, if imports increased, so would the payments. The CBSA determined that the total R&D intercompany fees were part of the value for duty allocated over the goods actually imported. In a potentially far-reaching decision, the CITT endorsed this decision where the importer could not show the payments were unrelated to the goods.

**Implications for business**

The Skechers Canada case demonstrates the recent enforcement trend of the CBSA toward assessing customs duty on intercompany management and other fees not included in the transfer price. It is important that companies review their supply chain structure and related intercompany agreements, taking the Skechers Canada case under consideration when importing goods into Canada through affiliated parties.

In Canada, at least for now, payments for “research, design and development” costs to the vendor by the importer, whether they result in actual production of the purchased models or are allocable to other non-imported models or aborted designs, are part of the value of the goods for customs purposes where the Canadian importer pays amounts that vary with sales and imports to an affiliate under a CSA.

See also the EY Tax Alert — Canada, “Related party R&D/design costs dutiable in Ernst & Young LLP (Canada)” (2014 Issue No. 16, 26 February 2014).
US issues valuation ruling on exclusive distribution rights; concept debate continues at WCO

U.S. Customs and Border Protection (CBP) has issued a ruling (HQ H242894) establishing that amounts paid by an importer to be the exclusive distributor of branded automobiles and parts are properly excluded from transaction value. The ruling is quite notable in the US, as CBP distinguished the facts of the case presented from those in Tikal Distribution Corp. vs. US, 13 F. Supp. 2d 1269 (CIT 2000), in which the court held payments for exclusive rights dutiable. It is also timely in light of the current review of a similar fact pattern at the World Customs Organization’s Technical Committee on Customs Valuation (TCCV).

While the right to resell a product is inherent in the authorized purchase of that product, the right to be the exclusive reseller for that product is not automatically conveyed with the product purchase. Conceptually, the right to be an exclusive distributor of a product is more valuable than the right to be only a distributor; exclusivity rights provide greater business certainty in building brand value and customer awareness in the marketplace without concern that the efforts will instead benefit a competitor who is also a distributor of the same products. Executing on the concept, however, requires both a precise definition of the exclusivity right in isolation and a way to accurately value that right.

Background of US ruling

The US ruling was requested by the US subsidiary of a foreign auto producer. As part of the business plan to better enable brand and sales development, the parent company, which owns the brand rights, proposed entering into a territorial exclusivity agreement with each of its distribution subsidiaries, including the US subsidiary. Under this agreement, the parent company will license the exclusive right to distribute branded vehicles and parts, as well as related intellectual property rights for building consumer brand awareness and creating product demand within a defined territory.

In exchange for the exclusivity rights, each distributor will pay a territorial exclusivity fee. The rights would be granted for a multi-year period, with the territorial exclusivity fee determined at the beginning of the period and paid in installments. The amount of each territorial exclusivity fee is independently determined and supported by an EY study.

The US distributor will distribute vehicles that may be produced by the parent or by any of the subsidiaries, including vehicles that are produced in the US. Parts may be purchased from both related and unrelated suppliers in a variety of countries.

CBP analysis

US law follows the WTO Valuation Agreement, with transaction value the preferred method of customs valuation. Transaction value is defined as the price paid or payable for imported merchandise, plus specifically enumerated additions. CBP analyzed the exclusivity fee to first determine whether it should be considered part of the price paid or payable, or, if not, should be considered an addition to transaction value.

Price paid or payable

CBP first looked to whether the territorial exclusivity fee should be part of the price paid or payable for the imported merchandise. Citing Generra Sportswear Co. vs. US, 905 F. Supp. 2nd 377 (Fed. Cir. 1990), CBP stated that all payments made by a buyer to a seller, or a party related to the seller, are presumed dutiable. In the prior case involving exclusive distribution rights, Tikal Distribution Corp., the importer was not able to overcome this presumption. In the instant case, however, CBP carefully reviewed the contractual terms, the method for determination of the fee, and support for the amount of the fee to conclude that the importer had overcome the presumption of dutiability.
Additions to value

CBP next reviewed whether the territorial exclusivity fee is an addition to transaction value as a royalty or license fee. To be an addition to value, a royalty or license fee must be related to the imported product and paid as a condition of the sale of the product to the importer. Again, conducting a detailed analysis of both the contractual provisions and payment mechanics, CBP concluded that payment of the fee is not a condition of sale of the imported product and consequently is not an addition to value as a royalty or license fee.

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

Global implications

Intellectual property issues have been among the most difficult customs valuation issues for both importers and customs administrations. Interpretation and guidance on the WTO Valuation Agreement is provided by the TCCV, a committee of customs administrations created by the WTO Valuation Agreement and administered by the World Customs Organization. While the guidance is not binding on any jurisdiction, customs authorities worldwide regularly cite its pronouncements.

The TCCV is currently reviewing a case study involving exclusive distribution rights, and the case study also involves a distributor of automobiles and parts. The US ruling is the only published, reasoned opinion of a customs administration that addresses a similar fact pattern.1 There is Canadian authority that excludes a fee paid to be an exclusive distributor from transaction value, but it deals with unrelated parties: Simms Sigal & Co. Ltd. vs. Commissioner of the Canada Customs and Revenue Agency, Appeal N0. Ap-2001-016 (Canadian Int’l Trade Tribunal 2003). A recent Indian case also ruled in favor of the importer, although the rationale is not detailed, and the decision is subject to further appeal: M/s Volkswagen Group Sales India Pvt. Ltd. vs. Commissioner of Customs, Mumbai, C/S/13671/12-Mum & Appeal No.C/524/12-Mum (2013). Particularly with the US ruling representing the view of the customs administration, and addressing each of the points of analysis necessary for the TCCV to reach a conclusion, it will be interesting to see the influence that the ruling has on TCCV proceedings.

Recent TCCV guidance on intellectual property issues has centered on royalties, as reported in prior issues of TradeWatch (Commentary 25.1 in the December 2011 issue and Advisory Opinion 4.15 in the March 2013 issue). In both Commentary 25.1 and Advisory Opinion 4.15, the TCCV has stated that when a customs authority analyzes a royalty payment under the WTO Valuation Agreement, it is possible to imply that a condition of sale exists even when no contractual condition is present and consequently determine that the royalty payment is an addition to dutiable value. Notably, the US exclusive distribution rights ruling analysis is consistent with a comprehensive review of the factors surrounding the granting and payment of the licensed rights, and it concludes that the rights are not dutiable. In an environment where it is seemingly increasingly difficult to exclude royalties from dutiable value, it would be encouraging to see guidance that some types of payments for intellectual property can properly be excluded from dutiable value when carefully structured and supported.

1 A 2011 unpublished Australian Valuation Advice concludes that an exclusive distribution fee is not dutiable.
Important attributes

Any separation of intellectual property rights from product cost requires a thorough analysis of both technical and practical aspects. The precise rights driving value need to be contractually defined in a manner in which they can be practically conveyed and valued in isolation. Additional contractual provisions on sublicensing, product supply and non-exclusively conveyed rights must be carefully drafted to support the concept. Both the transfer prices of the intellectual property and tangible property need to be independently established and supported consistently with the business approach, transfer pricing methodology and customs analysis. Income tax consequences of the separation must be analyzed and can create separate reporting requirements. As demonstrated by HQ H242894, when these items converge into a cohesive plan, significant customs benefits can result.

Ernst & Young LLP advised the importer in obtaining the ruling.

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Argentina
Argentina imposes new income tax collection system on triangular exports

The Argentine federal tax authorities (AFIP) issued General Resolution 3577/2013 (published in the Official Gazette on 7 January 2014), creating an income tax collection system applicable to Argentine exports where the country of destination for the goods differs from the country to which the goods are invoiced (triangular exports).

The amount to be collected shall be calculated at the 0.50% rate over the free on board (FOB) value of the export (same taxable base utilized for calculation of export duties). The rate will be 2% if the export invoices are issued to parties domiciled, incorporated or located in countries deemed noncooperative for tax transparency purposes.2

This tax surcharge (in Spanish, percepción) applies to exports (including different export systems, such as definitive exports for consumption, exports for consumption containing inputs that were imported previously on a temporary basis, etc.) The customs authorities will act as the agent collecting the tax, and the surcharge will be considered by the exporters as a payment on account of income tax (to be computed in the income tax return of the appropriate fiscal year).

Taxpayers can usually obtain exclusion certificates issued in accordance with AFIP’s General Resolution 830 to avoid surcharges whenever there are reasonable justifications (for instance, the avoidance of significant income tax excess credits). General Resolution 3577 specifies that the exclusion certificates will not apply for the surcharge established on exports. Thus, this surcharge will apply to every taxpayer, regardless of its particular income tax position.

Finally, the resolution changed the mechanism available for exporters to claim the reimbursement of VAT credits associated with exports. In this regard, taxpayers carrying out triangular exports subject to this new income tax surcharge will be subject to additional controls (pursuant to Title IV of AFIP’s General Resolution 2000) in order to obtain the approval of their reimbursement requests.

The provisions contained in General Resolution 3577 apply to “triangular” exports that have occurred since 7 January 2014.

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2 Per AFIP’s General Resolution 3576/2013, issued recently, the list of countries considered as cooperators for purposes of fiscal transparency includes: Albania, Andorra, Angola, Anguilla, United Arab Emirates, Armenia, Aruba, Australia, Austria, Azerbaijan, Bahamas, Belgium, Belize, Bermuda, Bolivia, Brazil, Canada, Cayman Islands, Chile, China, Colombia, Costa Rica, Croatia, Cuba, Curaçao, Czech Republic, Denmark, Dominican Republic, Ecuador, El Salvador, Estonia, Faroe Islands, Finland, France, Georgia, Germany, Ghana, Greece, Greenland, Guatemala, Guernsey, Haiti, Honduras, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Kazakhstan, Kenya, Kuwait, Latvia, Lithuania, Luxembourg, Macau, Macedonia, Malta, Mauritius, Mexico, Moldova, Monaco, Montenegro, Montserrat, Morocco, Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Panama, Paraguay, Peru, Philippines, Poland, Portugal, Qatar, Romania, Russia, San Marino, Saint Martin, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Tunisia, Turks and Caicos Islands, Turkmenistan, Turkey, Ukraine, United Kingdom, United States, Uruguay, Vatican City, Venezuela, Vietnam and British Virgin Islands. This is an exhaustive list; therefore, the remaining countries, dominions, jurisdictions, territories and associate countries not included in the list (such as Hong Kong), shall be deemed noncooperative countries. The tax authorities are empowered to update the list depending on the effective exchange of tax information achieved with the jurisdictions.
Brazil

São Paulo implements special regime to avoid accumulation of ICMS credits for import operations

Since Senate Resolution #13/2012 set the state value-added tax (ICMS) rate at 4% for interstate sales of imported products or products with import content higher than 40%, taxpayers in São Paulo have been accumulating significant credits on their balance sheets. The accumulation of credits is the result of the difference between the 4% rate and the 18% ICMS rate applied upon importation. Consequently, to avoid these significant credits, many taxpayers have been moving their operations out of São Paulo in order to import through other Brazilian states where the ICMS differential is not so large. However, this situation is likely to change.

CAT Ordinance #108/2013, recently published by the Finance Department of the State of São Paulo, authorizes the special regime for the partial or total suspension of ICMS assessed on goods imported for subsequent interstate sale. The regime is available to taxpayers with high and continuous credit balances. Among other requirements, the taxpayer must indicate the desired percentage for the suspended ICMS necessary to inhibit the creation of these credit balances.

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The Brazilian Government has been increasingly granting temporary tariff reductions to encourage trade and investment, increase technological innovation, and offset the shortage of domestic production in certain industry sectors. The regimes that provide these temporary tariff reductions can provide significant cost reductions for affected products and – given the current support by the Brazilian Government – should be considered for products with no domestically produced equivalent.

The “Ex-Tarifario” regime authorizes the temporary reduction to 2% import duty for approved machinery and equipment (i.e., capital) and certain information technology goods along with their parts and components. Without the reduction, such goods generally are assessed import duty at the rate of 14%, so the benefit is quite substantial. The regime, however, does not apply to used goods or integrated systems. This temporary tariff reduction may be granted when it is established that there is no domestically produced equivalent of these goods. In order to implement the reduction, the Brazilian authorities are allowed to create new tariff positions.

The “List of Exceptions” (also known by its Portuguese acronym, LETEC) authorizes MERCOSUR member states to keep some products out of the common external tariff (TEC) with well-defined deadlines for convergence to the TEC levels. Listed products may be subject to tariff increases or decreases based on the needs of each member state but also must be approved by all member states, taking into consideration WTO tariff commitments. Currently, the LETEC is composed of approximately 100 products.

Changes to the import duty rate may also be requested based on the Common Market Group Resolution #08/2008 in response to domestic market demand when there is a temporary shortage of supply. In this case, the Ministry of Development, Industry and Foreign Trade (known as its Portuguese acronym, MDIC) may establish the criteria for the allocation of quotas stipulated.

We have seen significant activity in the granting of temporary tariff reductions by the Brazilian Government recently. For example, during November and December 2013, temporary tariff reductions under Ex-Tarifario were granted to 141 industrial machines and equipment that were not produced domestically. Under the List of Exceptions, the import duty rate for frozen sardines was reduced from 10% to 2% with a quota of up to 30,000 tons until 30 April 2014 in order to maintain supply due to the interruption in fishing to allow for reproduction of the species. Additionally, five chemical products subject to temporary shortages in Brazil enjoyed tariff reductions to 2% for a 12-month period, subject to quota limits.

The application of the mechanisms for temporary tariff reduction may be requested by any company (or a consortium of various companies) to the Brazilian Government. In our experience, requests by industry organizations that represent many companies generally tend to be granted faster considering the organization’s major role in trade and economy and its close relationship with the Government. However, it should be noted that, regardless of who filed the application, the temporary tariff reduction applies to the product itself, not the applicant. As a result, any company that imports the affected product can benefit.

It is also worth noting that the tariff reduction also reduces the value basis for other taxes (i.e., IPI and federal VAT, known as Imposto sobre Produtos Industrializados or IPI), thus lowering these tax amounts as well. Additionally, some of the goods benefiting from a temporary tariff reduction are also excluded from the new unified ICMS rate of 4% (as discussed in the previous article, “São Paulo implements special regime to avoid accumulation of ICMS credits for import operations”), which helps to decrease or eliminate the eventual balance sheet credit situation.

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Mexico

New certification rules for VAT credit on temporary importations by IMMEX companies and other customs regimes

On 1 January 2014, the Mexican tax authorities finally published the new regulations that set out how companies can attain the certification required to benefit from a value-added tax (VAT) credit against the VAT that will apply to certain temporary imports from 1 January 2015.

Companies operating under the IMMEX\(^3\) (sometimes referred as Maquila) program and other customs regimes that involve the temporary or in-bond importation of goods for manufacture, transformation or repair (e.g., bonded warehouse for transformation and strategic bonded warehouse) may face costly cash flow consequences due to the recent Mexican tax reform. Consequently, taxpayers should carefully evaluate the benefits and costs of obtaining and maintaining the new certification. As we discuss below, such considerations should include an understanding of the implications for the company of the requirements and obligations, many of which are administratively burdensome and not necessarily related to VAT.

Background

As reported in the December 2013 TradeWatch (see article “Mexican tax reform to have significant impact on foreign trade operations”), temporary imports of goods and fixed assets under certain customs regimes have enjoyed an exemption from the import VAT (and excise tax as applicable); however, as a result of the recent Mexican tax reform, such temporary or in-bond imports are no longer exempted, and the general 16% VAT rate will apply starting next year.

While the VAT (and excise tax, as applicable) paid upon importation may be recovered through a credit against input VAT, or a refund when the finished product incorporating the imported goods is exported or transferred via virtual operations, the recovery process may cause significant cash flow inconveniences. As a compromise, the tax authorities agreed to establish a certification mechanism for companies affected by the new VAT on temporary imports to allow an immediate VAT credit against the import VAT payable to neutralize the adverse cash flow effects. (A certification for goods subject to excise tax is also available.) We note that the companies that choose not to obtain the certification can file a bond, issued by an authorized financial institution before the customs authorities guaranteeing the VAT (and applicable excise tax) payments for goods. Additionally, the tax authorities agreed to suspend the entry into force of the elimination of the VAT exemption until one year after the publication of the regulations for the certification. This delay allows companies time to meet the new certification requirements and avoid the negative cash flow effects of the import VAT that will be triggered on temporary and in-bond imports effective 1 January 2015.

VAT and excise tax certification – requirements and benefits

In general terms, the rules define three modalities of VAT and excise tax certification: A, AA and AAA. Rule 5.2.13 provides the general requirements that apply to all modalities and specific requirements in order to qualify for each modality, while Rule 5.2.14 defines the benefits provided by each modality.

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3 A program authorized by the Mexican Ministry of Economy under the Decree for the Promotion of the Manufacturing, Maquiladora and Exportation Services Industries.
General requirements and benefits of each modality

In order to demonstrate that the applicant to the certification is generally compliant with the corresponding tax and customs obligations, the fulfillment of the following requirements grants access to the respective benefits available, under each modality, as follows:

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Benefits</th>
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<tbody>
<tr>
<td>File an application with the tax authorities for the certification through the Single Window System (known by its Spanish acronym, VUCEM)</td>
<td>Tax credit for operations related to the relevant customs regime</td>
</tr>
<tr>
<td>Maintain an automated inventory control system for customs purposes</td>
<td>VAT refund within 20 days</td>
</tr>
<tr>
<td>Obtain a positive tax compliance opinion from the tax authorities for the taxpayer, its legal representatives, stockholders and board members that is issued no more than 30 days prior to the submission of the application</td>
<td>Certification validity of one year</td>
</tr>
<tr>
<td>Hold valid certificates of digital seals for electronic invoices that have not been deemed as invalid during the 12 months prior to the submission of the application</td>
<td></td>
</tr>
<tr>
<td>Provide records of all employees enrolled in the Social Security Institute and documentation supporting the payment of payroll contributions for 10 employees</td>
<td></td>
</tr>
<tr>
<td>Demonstrate the taxpayer’s investment in Mexico pursuant to the application manual</td>
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<tr>
<td>Indicate the name and address of foreign customers and suppliers with which the taxpayer carried out foreign trade activities during the previous year</td>
<td></td>
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<tr>
<td>Grant access to the personnel of the customs audit administration as required for the verification of the taxpayer’s compliance with the customs parameters</td>
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</tbody>
</table>
## Modality AA

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ All requirements applicable under A</td>
<td>▶ Tax credit for operations related to relevant customs regime</td>
</tr>
<tr>
<td>▶ At least 40% of the value of operations performed in Mexico in previous year were with suppliers that (1) have a positive tax compliance opinion, (2) have valid certificates of digital seals for electronic invoices and (3) are not on the list of noncompliant taxpayers; applies only to the acquisition of raw materials, under the respective program</td>
<td>▶ VAT refund within 15 days</td>
</tr>
<tr>
<td>▶ Operated under the relevant customs regime for previous five years, has an average of 1,000 registered employees during previous tax year, or machinery and equipment worth more than MXN50 million (US$4 million) during previous year</td>
<td>▶ Certification validity of two years, automatically renewable</td>
</tr>
<tr>
<td>▶ Not been subject to a tax assessment during previous 12 months; any deferred payments of omitted contributions do not exceed term of 12 months or have been paid</td>
<td>▶ Grace period of 30 days for the self-correction of irregularities identified by the taxpayer without penalties</td>
</tr>
<tr>
<td>▶ No VAT denials of an amount higher than 20% of the total amount of VAT refunds in previous 12 months, if the amount denied does not exceed MXN5 million (US$400,000 approximately)</td>
<td>▶ Issuance of an invitation (rather than formal request) by tax authorities to correct any presumptive omission of customs taxes</td>
</tr>
<tr>
<td>▶ Suspension procedure applies, regardless of cause identified by customs authorities to suspend the taxpayer’s importer/exporter registry</td>
<td>▶ Suspension procedure applies, regardless of cause identified by customs authorities to suspend the taxpayer’s importer/exporter registry</td>
</tr>
</tbody>
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### Modality AAA

<table>
<thead>
<tr>
<th><strong>Requirements</strong></th>
<th><strong>Benefits</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ All requirements applicable under A</td>
<td>▶ Tax credit for operations related to relevant customs regime</td>
</tr>
<tr>
<td>▶ At least 70% of the value of operations performed in Mexico in previous year</td>
<td>▶ VAT refund within 10 days</td>
</tr>
<tr>
<td>were with suppliers that (1) have a positive tax compliance opinion, (2)</td>
<td>▶ Certification validity of three years, automatically renewable</td>
</tr>
<tr>
<td>have valid certificates of digital seals for electronic invoices and (3)</td>
<td>▶ Grace period of 60 days for the self-correction of irregularities identified</td>
</tr>
<tr>
<td>are not on the list of noncompliant taxpayers; applies only to the acquisition</td>
<td>by the taxpayer without penalties</td>
</tr>
<tr>
<td>of raw materials, under the respective program</td>
<td>▶ Issuance of an invitation (rather than formal request) by tax authorities</td>
</tr>
<tr>
<td>▶ Operated under the relevant customs regime for previous seven years, has an</td>
<td>to correct any presumptive omission of customs taxes</td>
</tr>
<tr>
<td>average of 2,500 registered employees during previous tax year, or machinery</td>
<td>▶ Non-suspension of registry if customs authorities detect cause for</td>
</tr>
<tr>
<td>and equipment worth more than MXN50 million (US$4 million)</td>
<td>suspension to allow for correction of irregularity</td>
</tr>
<tr>
<td>▶ Not been subject to a tax assessment during previous 24 months; any deferred</td>
<td>▶ Option to file monthly consolidated customs declarations</td>
</tr>
<tr>
<td>payments of omitted contributions do not exceed term of 12 months or have</td>
<td>▶ Simplified option to demonstrate compliance with the regular automated</td>
</tr>
<tr>
<td>been paid</td>
<td>inventory control system requirement</td>
</tr>
<tr>
<td>▶ No VAT denials of an amount higher than 20% of the total amount of VAT</td>
<td>▶ Option to perform customs clearance of goods for their temporary</td>
</tr>
<tr>
<td>refunds in previous 12 months, if the amount denied does not exceed MXN5</td>
<td>importation without declaring serial numbers in customs declaration</td>
</tr>
<tr>
<td>million (US$400,000 approximately)</td>
<td>(such information must be maintained in updated inventory control system)</td>
</tr>
<tr>
<td></td>
<td>▶ Option to conduct customs clearance for exportation at the taxpayer’s</td>
</tr>
<tr>
<td></td>
<td>premises (under certain conditions)</td>
</tr>
</tbody>
</table>
In addition, IMMEX companies applying for any modality of the certification must fulfill the following:

- Valid IMMEX program
- All addresses linked to IMMEX program registered with the tax authorities
- Required infrastructure to perform IMMEX operations
- Value of goods transformed and exported during last 12 months represent at least 60% of value of imports (also applies to goods exported with no transformation with changes of regime or that received a service)
- Right to use the facilities where productive processes are carried out
- Description of activities related to productive process
- "Maquila" agreement, sales agreement or purchase orders that justify the export project

Furthermore, it is worth noting that on 27 February 2014, the tax authorities amended the rules that regulate the certification process and also issued the application manual, introducing several new clarifications and benefits. These include:

- The requirement that a certain percentage of operations be performed in Mexico with tax-compliant suppliers applies only to the acquisition of raw materials.
- The no-VAT-refund-denials requirement for the AA and AAA modalities is limited to 20% of the total amount of refunds authorized during the 12-month period.
- The submission of false information during the application process to the customs authorities is included among the causes of cancellation of the certification.
- Companies that are part of the same corporate group can provide information regarding employees, infrastructure and the amounts of investment through one company.
- Applicants to the certification under the AA or AAA modalities that do not meet the requirements can obtain the certification through another modality where the respective requirements are fulfilled. For example, if the applicant applies for the AA modality but meets the requirements only for the A modality, the company may be certified under the A modality without having to reapply.

**Application process**

Rule 5.2.13 provides the procedure for the application process. Basically, the customs authorities have a 40-day period to make a determination; otherwise, the application is deemed denied. Further, if the customs authorities determine that the taxpayer lacks the controls required to perform its productive processes, the applicant is disqualified from filing a new application for a six-month period.

Certification renewals must be filed within 30 days prior to the end of its validity, whereby the taxpayer demonstrates that all applicable requirements continue to be met. The customs authorities have a 20-day period to approve the renewal request; notably, if the resolution is not issued within this term, the certification is deemed renewed.

Finally, for companies that intend to apply for the certification during this year, the following calendar should be observed for submitting the application, which is based upon their tax address and the designation under the Regional Administration of Foreign Trade Affairs (ARACE):

<table>
<thead>
<tr>
<th>ARACE</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certified companies under Rule 3.8.1, Chapter L and companies operating under a bonded warehouse for manufacture of vehicles</td>
<td>1-30 April</td>
</tr>
<tr>
<td>North Pacific</td>
<td>15 April–15 May</td>
</tr>
<tr>
<td>Northeast</td>
<td>3 June–3 July</td>
</tr>
<tr>
<td>Central North</td>
<td>7 July–7 August</td>
</tr>
<tr>
<td>Central</td>
<td>7 August–8 September</td>
</tr>
<tr>
<td>West and South</td>
<td>22 September–22 October</td>
</tr>
</tbody>
</table>
Permanent obligations

Once approved, certified companies must also meet several permanent obligations established under Rule 5.2.16, which applies to all the modalities. These obligations include, among others:

- Complying with the requirements of their modality, allowing inspections to their facilities
- Notifying the customs authorities within five days of any changes to the taxpayer’s name or address, among others
- Filing a report to the customs authorities of modifications to their shareholders or legal representatives twice a year
- Performing all foreign trade operations with transportation companies registered with a Transporters Harmonized Alphanumeric Code
- For IMMEX companies, registering the companies with which they carry out virtual operations and providing the tax identification of those with which they perform sub-maquila processes

Cancellation

Rule 5.2.17 defines several situations in which the customs authorities can cancel the certification for cause. These include:

- Noncompliance with the conditions required for the certification or the permanent obligations
- Demonstrated cause for the suspension of the taxpayer’s importers/exporter’s registry
- Failure to demonstrate during an inspection by the customs authorities that the taxpayer maintains the infrastructure required to perform its productive process; the exportation, transfer or destination to another regime of its temporary imports of goods; or the legal permanence in Mexico of goods worth more than MXN100,000 (approximately US$8,000)
- Maintaining temporarily imported goods in addresses other than those specified in its program
- Noncompliance with terms defined by tax authorities for deferred payment of tax assessments
- Activation of a procedure for the cancellation of the taxpayer’s customs regime authorization

The rule provides that the customs authorities shall notify the taxpayer of the commencement of a cancellation procedure, indicating cause. The taxpayer then has a 10-day period to submit its arguments and respective proof to oppose cancellation. The customs authorities then have a 4-month term to issue the resolution, which, if negative, disqualifies the taxpayer from certification for the next 24 months.

Final remarks

Although the certification option to avoid the negative cash flow consequences of the recent Mexican tax reform is generally positive, the requirements and obligations to obtain and maintain the certification are extensive, and many have no relation to VAT.

Notably, the unequivocal underlying message in the rules is the increasingly common trend of taxpayer self-assessment for compliance, which is subject to verification by the customs authorities. Given the short deadlines for submissions upon request by the customs authorities, it is pertinent that companies seeking certification are well-prepared and possess strong internal controls for operations to maintain compliance and safeguard the benefits of certification.

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Puerto Rico's Treasury Department (PRTD) issued Circular Letter 13-22 (CL 13-22) to provide guidance to importers for purposes of paying the use tax on imported goods. The provisions of CL 13-22 apply to goods imported after 30 November 2013.

**Background**

Acts 46-2013 and 117-2013 amended Sections 3020.10, 3020.11, 4010.01, 4041.02 and 4042.03 of Puerto Rico's Internal Revenue Code of 2011 (Code) to require importers to submit information and pay the related use tax on imported goods (excluding inventory introduced for resale prior to 1 July 2014).

Section 3020.10 of the Code requires all importers, including bonded merchants that introduce articles from abroad, to file a Statement of Excise and Use Tax (Form SC 2005) with the Bureau of Consumption Tax (Bureau) for all articles received from abroad (excluding inventory introduced prior to 1 July 2014), in accordance with the procedure established by the Secretary of the Treasury, and specific information provided in the commercial invoice and bill of lading.

The importer must submit the statement and supporting documents before it takes possession of the imported goods. Bonded merchants must pay the use tax by no later than the 10th day of the month following the month in which it takes possession of the imported goods and complete the Monthly Return for Use Tax.

**Procedures for declaring and paying use tax**

CL 13-22 provides procedures for declaring and paying the use tax on imported articles by importers that are not registered merchants, importers that are registered merchants, bonded merchants and manufacturers.

**Importers that are not registered merchants**

Under CL 13-22, importers that are not registered merchants must declare and pay the use tax for imported articles in the following manner:

- The carrier electronically transmits the manifest to the Bureau and notifies the importer that the manifest has been sent to the Bureau.
- The importer must submit the statement to the Imposition Office of the Bureau or any satellite office, as defined in CL 13-22, after the manifest has been transmitted and no later than the date of introduction provided in the bill of lading. With the statement, the importer must submit the bill of lading, the original commercial invoice and a copy of the packing list.
- Immediately after submitting the statement, the importer or its authorized representative must electronically file the use tax return and pay the corresponding tax. To use the electronic system to file the return and pay the tax, the importer must obtain a registration number from the PRTD's website.
- The importer must complete a use tax return for each location receiving imported goods using the Application for Filing and Electronic Payment and must include the value of the imported goods. The total value of the imported goods included on each use tax return must be the same as what was included in the statement. Once the return is completed, the importer pays the use tax electronically.
- Once the importer completes the filing and payment process, it will receive a confirmation number for each payment made for each of the locations.
- The importer or its authorized representative must provide the Bureau official with the confirmation number, upon which the Bureau issues a Certificate of Tax Payment and issues an authorization for the release of the merchandise.
Importers that are registered merchants but not bonded merchants

The procedures for bonded importers that are registered are the same as those for importers that are not registered, except for the requirement to include in the monthly sales and use tax return the amount of the imported goods and the use tax paid for articles imported during the month.

Bonded merchants

The procedures for bonded merchants are similar to those for importers that are registered and those that are not. However, before the carrier transmits the manifest to the Bureau, the bonded merchant must obtain a number from the Bureau that confirms that the importer is a bonded merchant. To obtain the number, the importer must file a petition with the Secretary of the Treasury for a bonded merchant identification number and must pay a bond, which may not be less than US$10,000.

Once the Bureau validates the Statement of Excise and Use Tax, the PRTD will reduce the bond amount available by the amount of the use tax for all imported goods. If the amount of the bond is not enough to cover the use tax, the bonded merchant will have to pay the use tax related to all of the declared articles by following the procedures provided for registered and non-registered importers. The bonded merchant must complete the monthly use tax return no later than the 10th day of the month following the month in which it takes possession of the imported goods, after which the PRTD will release the amount secured from the bond.

Manufacturers

The Code specifically exempts the raw materials to be used by manufacturers. In order to take possession of the raw materials without being subject to the use tax, the manufacturer must ensure that its shipping documents are identified with its name and its manufacturer number assigned by the Bureau.

However, if the merchandise introduced by the manufacturer is not considered raw materials, the manufacturer must follow the procedures for the bonded merchant.

Procedures for requesting a bond

Under CL 13-22, the bonded merchant must file a sworn statement and describe the nature of the established merchant’s business, the number of shipments it expects to receive over the next 12 months and a description of the taxable merchandise with the percentage for the merchandise subject to the use tax, sales tax and excise tax. The sworn statement also should include information, such as whether the entity manufactures a product in Puerto Rico, whether the entity imports merchandise for another individual or company, and whether the entity imports merchandise into Puerto Rico for export, among other details.
The following documents should accompany the request:

- Copy of the Merchant’s Registration Certificate
- Clear debt certificate issued by the PRTD
- Clear debt certificate for purposes of sales and use tax issued by the PRTD
- Sales and use tax filing certificate issued by the PRTD
- Income tax return filing certificate issued by the PRTD
- Copy of the municipal license or clear debt certificate issued by the municipality in which the entity has its principal place of business
- Clear debt certificate issued by the Municipal Revenue Collection Center
- Audited financial statements by a certified public accountant licensed to practice in Puerto Rico for the preceding year
- Certificate of Incorporation or Certificate of Existence issued by the Puerto Rico Department of State
- Bond document (Form SC 2058) or “Continuous Bond” in its original
- The merchant will pay the bond determined by the Bureau. If the bond is not paid within the time established by the Code, surcharges, interest or an administrative penalty may apply.

As of 1 July 2014, all goods imported to Puerto Rico will be subject to the payment of sales and use tax. The bond will facilitate the introduction and payment process in these cases.

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Tariff classification and technology advancements – recent US court case highlights the challenges

The U.S. Court of International Trade (CIT) recently issued a landmark decision in Sony Electronics, Inc. vs. United States, Court No. 09-00043, Slip Op. 13-153 (Ct. Int’l Trade Dec. 23, 2013) (Sony), involving the classification of digital video cameras capable of capturing still and moving images. The case highlights a significant challenge facing importers and the customs authorities today as new and emerging technological advancements are complicating tariff classification determinations with the potential for customs duty implications.

Over the years, many changes have been made to the Harmonized Tariff Schedule of the United States (HTSUS) in an attempt to keep up with the advancement of technology with respect to video cameras. In 1996, subheading 8525.40.00 (still image video cameras and other video camera recorders) was introduced in the HTSUS. The following year, the word “digital” was introduced into the HTSUS in two new subheadings: 8525.40.40 (digital still image video cameras) and 8525.40.80 (other). In 2002, subheading 8525.40 was revised to read, “Still image video cameras and other video camera recorders: digital cameras.” Then, in 2007, subheading 8525.40 (television cameras, digital cameras and video camera recorders) was introduced, and two new subheadings, 8525.80.40 (digital still image video cameras) and 8525.80.50 (other), were introduced to replace 8525.40.40 and 8525.40.50, respectively.

Despite these updates, U.S. Customs and Border Protection (CBP) has grappled with the issue of classifying multi-function cameras. Considering that HTSUS 8525.80.40 is a duty-free provision and HTSUS 8525.80.50 is not, the issue has duty ramifications for affected importers.

In Sony, the case focuses on a 2007 ruling whereby CBP used the principal function analysis to determine that a digital video camera capable of capturing still and moving images was classified under subheading 8525.80.50 (other), subject to 2.1% duty rate. Sony argued that the proper classification was under the subheading 8525.80.40 (digital still image video cameras), duty-free. Sony filed a timely protest and initiated an action in the CIT. At issue was basically whether the term “digital still image video cameras” is limited to cameras that capture still images only, or includes cameras that digitally capture both still and moving images.

CIT agreed with Sony and determined that digital cameras capable of recording both still and video images are classified under subheading 8525.80.40 (digital still image video cameras). The CIT disagreed with CBP’s position that the phrase “still image video camera” is a term of art and took the position that the phrase is intended to be interpreted according to the meaning of its individual words. As such, the word “video” is intended to denote a moving image or motion picture, and the word “digital” is intended to distinguish between the cameras of 8525.80.40, which record using digital technology, from those of 8525.40.80, which use analog technology. Finally, CIT held that a principal function analysis under Note 3 to Section XVI of the HTSUS is not applicable as the merchandise is fully described by the subheading 8525.80.40.
Practical implications

Based on the Sony case, importers of similar products that were classified under 8525.40.80 may have an opportunity to protest any eligible customs entries, should the decision support a change in classification, and seek a refund for any overpaid duties.

Overall, the Sony case demonstrates the struggle that importers can face when technological advancements outpace the HTSUS. At the same time, this challenge can also be an opportunity for companies that actively review their tariff classifications to validate existing determinations against changes to the HTSUS and interpretations by CBP and the courts. The insight gained may open the door to new arguments that allow CBP to reconsider its position for a particular product, and the importer may have the opportunity to benefit from a duty-free or lower-duty tariff classification.

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Advance Export Information pilot program: volunteer exporter application deadline approaching

Introduction

On 31 January 2014, the U.S. Census Bureau (Census) announced that it was seeking volunteers to test a brand-new Advance Export Information (AEI) pilot program created to replace Census’ existing post-departure Electronic Export Information (EEI) filing option (still commonly known as “Option Four”). The existing post-departure filing program – already limited by a moratorium on new exporter applications since 2003 – was not designed to allow for advance shipping data collection critical to capture suspect activities before the export.

Thus, the proposed pilot AEI program has been updated to include the collection of sufficient exporter information from an agency enforcement and national security perspectives in advance of any export activity. Program participants will be able to export certain goods and technology where some shipment details are unknown or unconfirmed ahead of the shipment, but then they should complete the filing within five calendar days of the shipment’s departure once all information has been compiled.

The new AEI pilot program will require the following elements transmitted through the new AEI system prior to departure in accordance with existing time-and-place-based filing requirements as described in Foreign Trade Regulations 15 C.F.R 30.4(b) (i.e., EEI distinctions for vessel, air, rail, truck):

1. US Principal Party in Interest (USPPI) identification, including name, address, identification number and contact information
2. Details regarding the ultimate consignee
3. Commodity classification number (US Harmonized Tariff Schedule, Schedule B)
4. Commodity description
5. Port of export
6. Date of export
7. Carrier identification
8. Conveyance name/carryer name
9. License code/license exemption code
10. Shipment reference number
11. Authorized agent’s identification number (if an authorized agent is used to prepare and file the EEI)
12. Export Control Classification Number (where applicable)

Data elements that have been selected are those commonly available to an exporter prior to a departure. With the availability of the five-day window post-departure, those exporters participating in this program can now benefit from some additional time to file and to ensure the accuracy of their shipments for qualifying goods. For example, the shipping weight and final box count requirements could now be filed post-departure with the AEI pilot program, allowing exporters some flexibility where this data is often not known until goods are loaded on-board. Exporters with time-sensitive shipments or who transit perishable or diminishing-value goods that have been benefiting from the old Option Four program should continue to benefit in this new program, but they need to register as described herein. Those exporters who have not been able to take advantage of the post-departure filing option since the moratorium took effect can now consider benefits of the AEI pilot program by signing up as volunteer participants, as well.

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Application deadline approaching

Census will continue to accept applications for the AEI program until 1 April 2014. Every exporter interested in taking part in the program must file a new application prior to the deadline. Exporters that have been grandfathered in under the old post-departure filing program and are currently filing using Option Four should also consider applying, as Census has expressed its intent to replace the old program with the AEI program upon a successful test.

An exporter can apply directly to the Foreign Trade Division of the Census Bureau (no authorized agents may apply) by faxing a letter of intent on company letterhead detailing the applicant’s eligibility under the requirements set forth below. The application should include a point of contact and the Employer Identification Number (EIN) for each establishment the applicant wishes to include in the AEI program. Authorized agents may, however, transmit EEI through AEI on behalf of approved volunteer participants.

Key AEI pilot program benefits

- The availability of a post-departure filing option to complete any information unknown prior to departure may facilitate supply chain efficiency while eliminating delays caused by the difficulty in obtaining certain information prior to the shipment.
- Post-departure filing may cut costs associated with information gathering and data input requirements prior to the shipment where such information would be available only right at the moment of shipment or just after the export takes place.
- Participants may provide direct feedback to CBP and Census regarding program participation that may be used to further refine or enhance the final program model.
- CBP and Census intend to provide program volunteers with technical, operational and policy guidance through all stages of pilot participation. Such interaction may increase corporate preparedness for any future implementation of an AEI program and increase the likelihood that the exporter’s own business model will be considered in the ongoing enhancement of the AEI program.
- Participants in good standing at the conclusion of the pilot program trial period will not have to reapply for the AEI program if the AEI post-departure program will be continued.

AEI program participant eligibility

Pursuant to the Federal Register notice, all participants must meet the following criteria:

- Be the USPPI (authorized agents will not be considered)
- Have 12 months of export reporting history
- Report a minimum of 10 shipments per month (seasonal exporters may be considered on a case-by-case basis)
- Show an acceptable level of compliance for export reporting for the latest 12-month period
- Be compliant with all other federal regulations related to trade import and export transactions
AEI program conditions

It should be noted that the AEI pilot program is not for everyone. Volunteers may not use the pilot program to file for commodities controlled by the Export Administration Regulations (EAR) unless such commodities may currently utilize post-departure EEI filing. The AEI pilot program also specifically precludes participants filing for commodities exported under general or specific license issued by “any US government agency” (e.g., Office of Foreign Assets Control (OFAC) licenses) or any other shipments that expressly require pre-departure EEI filing pursuant to 15 CFR 30.4(a) (e.g., International Traffic in Arms (ITAR) items and routed export transactions).

As such, participants should evaluate whether their current export profile includes a significant number of exports subject to these limitations and determine whether participation in the program for the volunteer’s other commodities makes sense. Moreover, volunteer participants are required to engage in ongoing discussions and quality reporting (including meetings) with CBP and Census. Participants will not be able to recover any costs of AEI program implementation, and participants must be prepared to commit resources to training and technical implementation within 60 days of the AEI pilot kickoff. These considerations should be weighed against the program benefits listed above.

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Australian Industry Participation Plan now required for all major projects

Businesses involved in projects in Australia with a capital expenditure of AU$500 million or more are now required to prepare and implement an Australian Industry Participation (AIP) Plan. This is a sweeping change as previously AIP Plans were required only for projects seeking duty concessions under the Enhanced Project By-law Scheme (EPBS).

As we reported in the March 2013 issue of TradeWatch (“More Australian industry participation in major projects: implications for the Enhanced Project By-law Scheme”), the government initiative “A Plan for Australian Industry,” announced on 17 February 2013, was aiming to make the AIP Plan a requirement for all large investment projects, regardless of whether the company is seeking EPBS. This initiative became law on 27 June 2013 in the form of the Australian Jobs Act 2013 (Cth) (the Act), which entered into force on 27 December 2013. On 24 December, Grant Wilson of the Australian Industry Participation Branch was appointed as the Chief Executive of the Australian Industry Participation Authority (AIP Authority), the statutory body tasked with administering the new legislation. The initiative is intended to promote Australian job growth by ensuring that Australian industry is provided with the opportunity to win work on major projects.

The impact of this initiative on existing and prospective EPBS projects has been clarified in a recent legislative rule issued by Ian Macfarlane, the Minister for Industry. The legislative rule, which was released on 9 February 2014, provides an exception to the requirement for businesses to complete an AIP Plan under the Act for projects for which an AIP Plan has received approval under the EPBS before 7 February 2014. From this date onward, businesses that receive AIP Plan approval under the EPBS will be required to comply with obligations under both the EPBS and the Act.

A project proponent’s AIP Plan must demonstrate how its project will provide full, fair and reasonable opportunity to Australian industry to supply goods and services to its project. A draft AIP Plan and guide have been published by the AIP Authority, and both are available on the Department of Industry website.

To ensure compliance with the Act, a project proponent should prepare an AIP Plan early in the planning stage and understand the implications of the associated compliance obligations.

Despite the initiative only recently becoming operative, the status of the AIP Authority and the Act is currently being reviewed as part of the Government’s National Commission of Audit. Watch for further updates in future issues of TradeWatch.

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Stricter penalties under recent amendments to the Infringement Notice Scheme

Effective 1 February 2014, changes to the Infringement Notice Scheme (INS) pursuant to the Customs and AusCheck Legislation Amendment (Organised Crime and Other Measures) Act 2013 mean that importers, exporters and their agents (e.g., customs broker, cargo reporter) face increased exposure to penalty risks. The legislation is aimed at preventing fraudulent declarations and dealings with the customs authorities at Australia’s borders; however, the significant increase in penalties and the introduction of new offenses can affect any importer as well as other stakeholders that engage in international trade activities at Australia’s border.

Some of the key offenses under the INS relate to making self-assessed clearance declarations, broker license conditions and dealing with Australian Customs officers. The legislation also includes new regulations relating to operational aspects of the INS, including processes relating to extending or withdrawing an infringement notice.

Cargo reporters and importers should be particularly mindful of the new self-assessed clearance declaration offenses. A self-assessed clearance declaration is required for imported goods valued below AUS$1,000. Under the new INS, if more than one self-assessed clearance declaration is made in respect of goods, this will attract a penalty of AUS$1,275 for a natural person and AUS$7,650 for a body corporate (i.e., company).

The new offenses in dealing with Australian Customs officers are aimed at strengthening Australian Customs’ ability to obtain information. Any person who fails to answer questions or produce documents or records will attract a penalty of AUS$1,275 if a natural person or AUS$3,825 if a body corporate.

If a recipient does not pay an infringement notice, Australian Customs may prosecute them for the alleged offense. However, a withdrawal or extension of an infringement notice can be requested. A withdrawal request needs to be made in writing to Australian Customs before the due date for payment and needs to be accompanied with evidence or information that assists Australian Customs in making a decision. Alternatively, if a recipient seeks an extension of the due date for payment, they need to request this in writing and include the circumstances as to why they are unable to pay.

These new INS amendments affect various stakeholders who engage in international trade activities at Australia’s borders. All stakeholders should ensure active compliance with these new controls as Australian Customs has a strong focus on combating organized crime and improving compliance.

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Korea-Australia Free Trade Agreement concluded

On 5 December 2013, the Australian Government announced that negotiations for the Korea-Australia Free Trade Agreement (KAFTA) had concluded. South Korea is Australia’s third-largest export market and fourth-largest trading partner. With bilateral trade of AUS32 billion in 2012, it is expected that KAFTA will provide major opportunities for Australian businesses. KAFTA will not enter into effect until both the Australian and South Korean governments complete domestic ratification procedures. This is expected to occur in the first half of 2014, with commencement likely to be in early 2015. Chief Negotiators initialled the text of the agreement on 10 February 2014 and released it to the public on 17 February 2014. Accordingly, details with respect to which products will become duty-free immediately when the agreement enters into force, and specifics with respect to the tariff phaseout schedule for other products, are now available. KAFTA will see tariffs eliminated on key Australian agricultural exports to South Korea, including beef, wheat, dairy, sugar, wine and seafood. Other sectors set to benefit from the removal or phaseout of existing tariffs or the removal of certain non-tariff barriers include professional services, energy and minerals, manufacturing, and investment.

Now that the specifics of the agreement are publicly available, companies should be identifying opportunities to benefit under KAFTA. Specifically, Australian importers and exporters to South Korea should identify goods that are manufactured in Australia and South Korea and consider how much processing is being conducted locally, as these considerations will have an effect on whether the goods will ultimately be eligible for preferential tariff treatment, based on the product’s rule of origin as defined in KAFTA. Given existing high tariff rates into South Korea, this agreement will be very beneficial for some Australian exporters.

The conclusion of KAFTA negotiations follows the Australian Government’s promise to fast-track current free trade negotiations. The Australian Government is currently negotiating agreements with China, Indonesia, Japan and India and is a party to the Gulf Cooperation Council (GCC), the Regional Comprehensive Economic Partnership (RCEP), the Pacific Agreement on Closer Economic Relations Plus (PACER Plus) and Trans-Pacific Partnership (TPP) negotiations. Watch for further updates in future issues of TradeWatch.

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China

Significant changes to China's customs valuation regulations

The General Administration of Customs (GAC) recently released new customs valuation regulations that seek to clarify certain outstanding matters but also separate the valuation treatment on bonded versus non-bonded goods. Two administrative rules, Decree of GAC [2013] No. 211, PRC Customs Valuation Measures for Determining the Dutiable Value of Bonded Goods for Domestic Sale (Decree 211), and Decree of GAC [2013] No. 213, PRC Customs Valuation Measures for Determining the Dutiable Value of Import and Export Goods (Decree 213), have replaced the previous valuation regulations, Decree of GAC [2006] No. 148 (Decree 148).

The above-mentioned decrees, which took effect from 1 February 2014, represent one of the most significant changes to China’s customs valuation measures since Decree 148 was issued almost eight years ago.

Overview

There are numerous changes to the structure and content of the valuation regulations with the release of these new Decrees. One of the major changes is the detail regarding customs valuation treatment on bonded goods that will be sold domestically (including those under the processing trade/customs handbook program, goods processed in or bonded logistics goods imported through Customs Special Supervision Areas). These have been separately and independently addressed in Decree 211.

Meanwhile, the overall structure and the majority of general customs valuation provisions from Decree 148 for domestic and non-bonded goods remain unchanged by Decree 213; however, a few clarifications have been added. The following illustration shows how the customs valuation regulations from Decree 148 have now been separated into the two new Decrees:

Decree 148
- Valuation on imported goods under general trade
- Valuation on bonded goods for domestic sale
- Valuation under other trade modes
- Valuation on exported goods
- Calculation of transportation and insurance fees
- Valuation procedures

Decree 211
- Valuation on bonded goods for domestic sale

Decree 213
- Valuation on imported goods under general trade
- Valuation under other trade modes
- Valuation on exported goods
- Calculation of transportation and insurance fee
- Valuation procedures
Decree 211: major changes for customs valuation of domestic sales of bonded goods

Decree 211 has been drafted to revise, clarify and expand upon the four Articles in the previous Decree 148 (Articles 27–30) that directly related to domestic sales of bonded goods. This is a growing area of business activity in China as manufacturers evolve from pure export factories to also supplying the domestic market.

Decree 211 follows the “transaction value” principle fundamental in the World Trade Organization’s Valuation Agreement, which was included in Decree 148. Taking into consideration that the importation of bonded goods and goods imported via Customs Special Supervision Areas are subject to different commercial arrangements that can impact the customs valuation treatment, Decree 211 further clarifies how China Customs examines and determines the dutiable value of goods for domestic sales under different scenarios.

For example, for enterprises selling bonded processing raw materials or finished goods from Customs Special Supervision Areas to the domestic market, the dutiable price is no longer based on the import price of identical or similar goods. Rather, the dutiable price is now determined on the basis of “domestic sales price” of the goods. Bonded storage fees and other charges incurred within Customs Special Supervision Areas will no longer be included in the dutiable value (while previously, many of these charges had been assessed as subject to customs duty upon importation into the domestic market).

This change will help import/export enterprises to further reduce their import tax costs. However, we note that further guidance for this determination, such as whether the profit generated in the Customs Special Supervision Area is included in the “domestic sales price,” would be helpful.

Overall, compared to the previous regulations, the new rules remove a lot of ambiguity around the dutiable price and make it easier to determine the correct customs value for domestic sales of bonded goods.

Decree 213: limited changes for customs valuation of goods imported under General Trade and other trade modes

The structure and most of the content of Decree 148 with respect to goods imported under General Trade and other trade modes have been carried over to Decree 213. There are, however, still some important changes.

A notable update to highlight is that for related party transactions, the “circumstances of sale” test, a widely recognized customs valuation principle, has been added to China’s valuation regulations. This addition provides importers with greater flexibility to explain and support their “transaction values” in terms of customs valuation principles so as to convince China Customs of the reasonableness of the declared values.
Areas in need of further clarification

While a number of important areas have been further clarified or added to the new regulations, quite a few areas still need clarification. For example, with the separation of the valuation regulations into two Decrees, it is not clear:

- Whether there will be any corresponding realignment of responsibilities between the internal China Customs Departments for the valuation of bonded or non-bonded goods
- How procedural matters, such as a valuation dispute, should be handled between an importer and China Customs for bonded goods sold domestically, considering that the technical and procedural articles of Decree 148 were not included in Decree 211 (although included in Decree 213)
- How items normally subject to adjustment under “transaction value” (e.g., royalty fees, commissions and proceeds of sales) are treated for bonded goods sold domestically, considering that such items are not mentioned in Decree 211

Conclusion

Decree 211 and Decree 213 are big updates to customs valuation matters in China, considering that Decree 148 was issued many years ago. The Decrees further clarify many issues in detail, and some of the original provisions have been amended and improved. However, there is still some room for further clarification, and we suggest that businesses keep an eye out for further developments.

See also the Ernst & Young LLP (China) Advisory Limited Indirect Tax Alert, “China Customs announces significant changes with new customs valuation regulations” (January 2014).

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Understanding the application of the Resource Utilization Support Fund on imports

Decree no. 88/12944 established the Resource Utilization Support Fund (RUSF), a tax assessed on loans provided by banks and consumer financing companies, which is also collected on certain imports that are financed by credit.

The Turkish customs authorities have been actively reviewing whether taxpayers are properly paying RUSF on imports, which is assessed at the rate of 6%. This is a challenging area for importers because the decree and respective regulations are vague from a customs standpoint and because international financing is complex.

Application of RUSF on imports

According to the Decree, the collection of RUSF applied on goods imported for free circulation depends on the financing arrangement for that importation. Specifically, the following financing types will subject the imported goods to RUSF withholding upon importation:

- Acceptance credit
- Deferred letter of credit
- Cash-against-goods payment

However, if the amount financed is paid prior to importation, then the goods are not subject to RUSF if certain conditions are met and documented. Additionally, it is important to emphasize that imports paid in advance (i.e., cash in advance, cash against documents or letters of credit) may also be subject to RUSF upon importation unless certain conditions are met and documented.

In other words, goods imported for free circulation are subject to RUSF unless proven otherwise. Accordingly, importers need to understand the conditions and documentary requirements necessary to support all instances where RUSF should not be applied. In this respect, Circular no. 2011/16 provides some guidance. The circular states that the payment must have been deposited before or on the registry date of the customs declaration for free circulation. The pro forma invoice or sales invoice date and the transfer of payment by the bank must also support this date. We emphasize the following factors to be considered:

- Registry date of the import declaration (for free circulation)
- Date of the transfer of the payment
- Document supporting the bank transfer

Another consideration is whether the application of RUSF applies to goods imported through a special customs regime. The Decree implies that RUSF applies only to goods imported for free circulation. It is important that taxpayers keep in mind, however, that once such goods subject to a special customs regime are imported for free circulation — whether at a later date or after undergoing processing — RUSF may apply if the advance cash payment conditions have not been met.

Additionally, we note that it is not always clear whether RUSF applies under other financing structures, such as where the import cost is paid through a domestic finance company. In these cases, some guidance can be gained from tax rulings issued by the Ministry of Finance.
Application of customs penalties

Although controversial, RUSF is considered an import duty and thus subject to the customs laws and regulations, particularly with respect to penalties for noncompliance. Under the Turkish Customs Code, “import duties” are defined as “customs duties and other additional financial liabilities and taxes with equivalent effect.” RUSF is treated as a tax with equivalent effect.

Customs law no. 4458 provides for extensive penalties, which includes the practice of “threefold of import duties.” Accordingly, RUSF that is not collected is subject to penalties of three times the underpayment. Considering that value-added tax (VAT) is also assessed on the RUSF payable upon importation, the penalty amount will also include an amount for three times the underpaid VAT. Additionally, delay interest on the total amount will be assessed. As a result, penalty amounts can quickly become significant.

We note that penalty amounts can be subject to settlement discussions with the customs authorities. In our experience, the tax principal amount is not subject to a reduction, but a penalty reduction of up to 75% has occurred under certain circumstances.

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East African Community

Customs authorities focus on post-clearance audits

With increasing trade volumes, trade facilitation initiatives to reduce clearance times and limited resources, the customs authorities around East Africa have been moving to risk management and audit-based controls to seal revenue leakages and enhance compliance. In doing so, the East African Community (EAC) partner states have put in place post-clearance audit (PCA) teams to audit select taxpayers sometime after the clearance of cargo through customs. The implications for importers are significant.

PCA involves the review of taxpayer records (relevant customs documentation, commercial documents, business systems, etc.) sometime after the importation of cargo to verify compliance with the customs laws and regulations and to ensure the proper amount of duties and related taxes is paid. For the customs authorities, PCAs are already proving to yield very high tax collections. Part of the reason is that importers have traditionally relied on their customs agent (the only party authorized to make customs declarations) to determine and remit the duty amount and retain relevant records. Incorrect declarations or the non-remittance of taxes by importers will generally be discovered only upon audit. Systemic errors (e.g., consistently declaring an incorrect tariff classification for an extended period) in this context can prove very costly.

Key areas audited

In our recent experience supporting clients in reconciliations and objections/appeals during and after PCAs in several EAC member states, we find there are key areas of concern that PCA teams are focusing on that are leading to the issuance of assessments/demand notes.

1. Customs valuation

The PCA team will review whether the taxpayer declared the correct customs value. Customs valuation within the EAC is based on the World Trade Organization Valuation Agreement, with transaction value being the primary method. The EAC customs valuation base is “cost, insurance and freight” (CIF) with consideration of any required adjustments per the customs rules. Some customs valuation exposures identified during PCAs include:

- Use of fake/incorrect invoices to declare values to the customs authorities
- Failure to make additions to the paid for royalties, license fees, assists or commissions, pursuant to the customs valuation rules
- Omission of some elements of CIF from the customs value
- For related party transactions, failure to prove that the relationship between the buyer and seller did not affect the price under the transaction value method

2. Tariff classification

All imported goods are classified under the EAC Common External Tariff of 2012 using a specific tariff code, which determines the appropriate tariff rate assessed on the customs value to compute the applicable duties. Establishing the correct tariff code is easier for some goods than others. This exercise is important as the wrong classification of goods may lead to the underpayment or overpayment of duties.
3. Country of origin

Particularly when preferential tariff rates under economic blocs or customs unions are involved, the country of origin is a focus of the PCA team. For instance, any goods originating within the EAC will attract a 0% import duty rate; goods originating from a COMESA country for importation into Uganda or Kenya attract preferential tariff rates generally lower than the general external tariff; and goods originating from SADC into Tanzania will attract a 0% duty rate. A certificate of origin must be submitted to the customs authorities at the time of customs clearance for the application of the preferential tariff rate.

Common risks for country of origin include:

- Claiming preferential tariff rates without a certificate of origin
- Refusal by the customs authorities to accept the certificate of origin because the origin rule requirements were not met

4. Exports and re-exports

Generally, the EAC countries do not apply export taxes on exported goods. However, there are export declaration requirements, primarily to prove that goods were exported and for statistical trade purposes. The PAC team may verify that the goods in export or re-export sales did actually leave the territory, otherwise applicable domestic taxes (i.e., value-added tax, excise duties) may apply.

5. Temporary importations

Goods imported under bond on a temporary basis can benefit from the suspension of customs duties and import taxes. The PCA team may verify that the goods were either returned to their original country or applicable taxes were paid should the goods enter the local market.

6. Remittance of computed taxes to the customs authorities

In addition to verifying the amount of duties and applicable taxes owed, the PCA team will also confirm that the appointed agents actually remitted the amount to the revenue authorities. In some cases, it has been discovered that funds remitted to customs agents for payment of taxes were not actually paid to the customs collection accounts. In the end, the importer’s lack of oversight over the customs agent can mean that the importer still owes the duty plus penalties and interest to the customs authorities.

Be prepared

Companies that import regularly should expect that a PCA will be conducted every three years or more frequently if the company is considered high-risk (e.g., suspicion of fraud, tax evasion or high-value imports). In our experience, PCAs can be very costly and administratively burdensome for unsuspecting importers. Companies found to be noncompliant not only face high customs duty and penalty liabilities, but can also lose out on incentives, such as withholding tax on imports or Authorized Economic Operator (AEO) status.

In preparing for the PCA, companies should conduct an internal review to assess their compliance and work to close any compliance gaps. Doing this in advance also provides the opportunity to voluntarily disclose any noncompliance to mitigate penalties and fines. Additionally, such efforts can help identify new duty savings opportunities and improve internal controls and processes.

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Controversial new tax on imports: the railway development levy

The railway development levy (RDL) was introduced in Kenya in August 2013 as an amendment to the Customs and Excise Act, through the Finance Act, 2013. It applies to all imported goods for home use at a rate of 1.5% of the customs value of the goods. The levy is specifically targeted at financing the construction of a standard gauge railway from Mombasa to Kenya’s western border, opening up East Africa’s hinterland to the speedy transportation of goods. A similar railway project is proposed in Ethiopia, which will allow its neighbor South Sudan to export oil through the Mombasa port.

The Government has so far collected close to the targeted revenue, and it is hoped the targeted revenue will be hit by July 2014. However, a lack of regulations stating how the tax is to be applied, for instance, on privileged persons and Export Processing Zones (EPZ) has led to the distortion of certain tax policies meant to protect or otherwise bolster industry. Such taxpayers, who are exempt from paying customs duty under the East African Community Customs Management Act have had to bear the weight of the levy nonetheless.

The introduction of the RDL was quickly followed by the commissioning of Berth 19 by the Presidents of Kenya, Uganda and Rwanda, touted to complement the railway to Malaba on Kenya’s Western border. Also, EAC countries, with the exception of Tanzania, agreed to conduct all administrative customs work at Mombasa, reducing non-tariff barriers (NTBs) to the free flow of goods into the region. These three events, however, have actually led to delays in the clearance of cargo and increased storage charges.

Further, the lack of regulations also makes it unclear if an investor can apply for remission of the levy if importing capital items, such as plant and machinery. In this particular regard, the Kenya Revenue Authority (KRA) is set to collect heavily from oil and gas companies whose projects are capital intensive. Companies in this industry may, however, find it easy to absorb this cost or pass it on to the next party in the value chain once profitable deposits are discovered and the oil well is sold off to an exploration company.

Under the Tax Remission for Exports Office (TREO) system that Kenya operates, exporters in Kenya are allowed to apply for remission of duty on raw materials for the manufacture of exports. With the introduction of the RDL, these exporters are charged the levy, yet the definition of duty includes levies. This is an extra cost to the exporters. These extra costs make Kenyan exports uncompetitive both regionally and continentally and also hurt the country’s balance of payments.

The levy may be done away with as soon as the standard gauge railway is completed within the projected period of three years, as it was introduced to secure the necessary financing from China for this huge infrastructure project. The two things the standard gauge railway is projected to do are to reduce turnaround time and the cost of importation of goods. For landlocked countries, such as Uganda, Burundi, Rwanda and Ethiopia, this will have a real impact on bolstering the purchasing power of households and dampening inflation. Further, with a railway of that magnitude, Mombasa will easily rival Dar es Salaam as the port of choice on the East African coast – further cementing Nairobi’s position as the East region’s business hub.

Greater formalization of RDL’s application with consultation from all stakeholders such as manufacturers, importers, clearing agents, KRA and EAC Partners will be vital in achieving the RDL’s goal. Putting the collected revenues to good use will also be vital.

Therefore, there is urgent need to regularize the application of the RDL through the publication of enabling regulations promulgated by the Kenya Cabinet Secretary in charge of Treasury. These regulations must include provisions of how RDL is integrated into TREO; the exemption of privileged persons, such as diplomats; and special international organizations and EPZs. In the meantime, players in capital-intensive sectors such as oil and gas can lobby for the remission of RDL on the importation of heavy plant and machinery, especially as the country transitions from exploration to production.

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Introduction of the Electronic Cargo Tracking System (ECTS) in Uganda

Today, customs authorities worldwide are increasingly placing more emphasis on customs modernization as a strategy to facilitate trade while also improving trade compliance and revenue collection. A key component of customs modernization is the use of electronic over manual monitoring of imported goods, which serves to reduce paper documentation, eliminate bureaucratic procedures and lessen interface with customs officials. This, in turn, frees the limited customs resources to be better directed at high-risk imports. The launch of the Electronic Cargo Tracking System (ECTS), a component under the Customs Business Systems Enhancement Project (CBSEP), by the Uganda Revenue Authority (URA) is thus a step in the right direction.

The Electronic Cargo Tracking System (ECTS)

The ECTS is an electronic solution that eases the monitoring of all cargo/goods in transit. It provides timely accountability of the changing location of goods in transit in real time and on an instantaneous basis. The cargo in transit is securely monitored by activating tracking devices (e-trackers and e-seals) attached to the transit trucks at customs points and deactivating them at the destination or exit point of the cargo. This system enables real-time alerts in case of any tampering with seals or diversion of cargo and gives full operational audit trail and data recovery in the event of data/information tampering or loss.

The project was launched in November 2013 and started as a pilot scheme covering motor vehicle units, high-risk transit consignments and transit goods from Rwanda, through Uganda, and to Mombasa, Kenya. The ECTS solution is rolling out to cover all goods declared for transit through Uganda in March 2014.

Uganda has followed Kenya and Tanzania, which adopted the system in 2011 and 2012, respectively. Rwanda is expected to launch its version soon, leaving Burundi as the only member state in the East Africa Community yet to embrace the technology.

Benefits of the ECTS

The ECTS will benefit the various participants in international trade, including the customs authority, the traders (especially importers), the customs/clearing agents and the transporters. We highlight some of the benefits below:

- As with information communication technology (ICT) innovations, the advent of electronic monitoring of goods in transit will end the manual monitoring of transit goods using manned roadblocks and the various physical checkpoints littered along transit routes. The Uganda Revenue Authority will for the first time have a centralized ICT nonintrusive system that allows the customs authorities to monitor all cargo in transit on a real-time basis and on varied electronic platforms (computers, phones, etc.). This will reduce the dumping of goods in transit on the local market in Uganda and hence increase revenue for Customs.

- The traders, particularly importers, and their customs agents will be able to electronically monitor the location of the goods in transit in real time. The payment of escort fees to soldiers to escort the cargo out of Uganda will no longer be necessary. Transport and related costs caused by delays at the various checkpoints will be checked, hence making it easier and cheaper to move goods out of Uganda.

- The transporters will also be able to monitor their trucks and enforce effectiveness of the drivers, thereby reducing costs incurred because of overstay by their drivers on the transit routes. The greater the turnaround times of transit trucks, the more turnover in business for the transporters.
Though the customs agents will continue to bear the burden of staking security by way of the bond in force (BIF) to guarantee that any imported goods that they have declared for transit will exit from Uganda, ECTS will facilitate trade through timely execution and cancellation of bond guarantees. The cogent evidence trail accessed from the ECTS will ensure that customs agents are not unfairly charged BIF when the goods actually exited. They will also be able to monitor goods over which they have executed a transit bond and to alert the customs authorities in case of diversion of their clients’ cargo.

However, the innovation is not without cost to the different players involved. The URA is expected to incur US$5.2 million to fully install the system. The tracking devices are to be procured and installed by the transporters for US$700 and US$1,000, a cost that will inevitably be passed on to the importers but ultimately borne by the consumers. This move is likely to increase the cost of goods within the region in the short term.

By and large, ECTS is a welcome modern tool that will facilitate trade by easing and increasing international trade in Uganda and in the wider East African Community.

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