TradeWatch

EY Global Trade

Issue 3 2024

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Welcome to Issue 3 2024 of *TradeWatch*

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Welcome to Issue 3, 2024 of *TradeWatch*, the global EY organization's global trade magazine.

In this final issue of the year, we look at some key trends and themes that are impacting trade now, including trade protection measures, trade technology, and trade controversy and we consider the impact of Brazil's tax reform on customs as it moves to the next stage.

Two of our articles focus on the life sciences sector addressing important topics for this key industry: Recent trends in life sciences – impact on the global trade function and Life sciences: Addressing the impact of evolving export controls and sanctions.

We also examine themes that are likely to continue to dominate the trade agenda in 2025.

The US election – a shift in US trade policy?

Following the United States (US) presidential elections on 5 November 2025, the Republican candidate, former President Donald Trump, secured the electoral votes needed to become the 47th President. He will officially take office on 20 January 2025. The US plays a pivotal role in shaping international trade dynamics and the outcome of this election is set to have a significant impact on trade policies, global partnerships, tariff structures and the overall economic landscape, both in the US and abroad – see United States: Election outcome – potential impact on global trade. Therefore, the implications of the election are now at the forefront of economic discussions around the world.

Trade protection measures – sanctions and antidumping

Conflicts around the world continue to contribute to the imposition of trade sanctions and export controls, which are often introduced at short notice. In addition, an increasing number of trade protection measures are being adopted to protect specific industries. In this issue we feature several articles on this topic, including measures from Canada in Surtaxes on Chinese-origin EVs and steel and aluminum products; from the European Union (EU) in three articles – Countervailing duties on imports of battery electric vehicles from China, Restrictive measures against Russia and Antidumping measures as trade remedies and from the Asia-Pacific region in three articles: China: Recent customs updates, Japan: Interim report on the revision of export control regulations and Korea: Overview of customs law changes for 2025.

Controversy

Trade controversy continues to be an important topic for the trade function to manage, including preparing for customs audits and dealing with disputes. In this issue we cover controversy topics from the EU in Sale-for-export principle once more subject for debate, from Korea in Overview of customs law changes for 2025, from Mexico in Strategic preparation for enhanced customs audits, and from New Zealand in Customs' compensatory interest regime.

Technology

Technology continues to facilitate customs obligations and provide opportunities for trade functions to operate more effectively. In this issue we focus on Electronic customs filing and on the Advantages of a unique license-free defense environment in Australia. However, technology may also increase the efficiency and scope of customs audits, making it more important than ever for businesses to prepare. This theme is featured in Mexico: Strategic preparation for enhanced customs audits. And as cross-border e-commerce sales proliferate, countries such as Türkiye are adopting new rules for cross border sales to final consumers as featured in The impact of changes for cross-border e-commerce.

Outlook for 2025

Looking forward to 2025, it is hard to predict all the challenges that global trade functions may face, but it is likely that several trends that emerged in 2024 will continue to be important. The Trump presidency will almost certainly bring crucial trade developments, including trade protection measures, that may in turn influence the trade policies of China, the EU, India and the United Kingdom (UK). Even in 2024, we continue to experience a high degree of legislative change and that seems likely to continue in the next year. In particular, we expect to see a lot more clarity in the EU as it reforms its customs legislation.

Sustainability has been a common theme running throughout recent issues of *TradeWatch*. As regulators in many countries have turned their attention to how goods are produced, we have seen a proliferation in environmental, social and governance (ESG) measures globally. In addition to measures preventing deforestation – see EU: Deforestation Regulation: an underestimated challenge – and the use of forced labor, Carbon Border Adjustment Mechanisms (CBAMs) in the EU and UK have dominated the agenda for many trade functions – see CBAM – a balancing act. This trend seems likely to continue as countries continue to tackle the issue of climate change.

The increasing role of artificial intelligence (AI) will also likely have an impact on business operations and on customs administrations, potentially leading to more efficient processes but potentially also increasing scrutiny for businesses using trade data, for example, to identify trade issues such undervaluation of imports or noncompliance with sanctions regimes. If there is an economic downturn, controversy may also increase as countries seek to improve trade compliance and reduce tax gaps. In this regard, the interplay of customs valuation with transfer pricing seems likely to be a continuing hot topic for trade functions and specialists alike.

Keeping up-to-date with developments in trade

We hope you enjoy this edition of *TradeWatch*. We aim to reflect the key trends affecting international businesses and provide news and insights you can use to inform your trade strategy and improve your trade operations.

You can also keep up-to-date with developments in global trade by subscribing to EY Tax Alerts and to future editions of our *TradeWatch* and *TradeFlash* publications by visiting ey.com/global trade. You can subscribe to future webcasts and access replays of past webcasts via the EY webcasts page.

If you would like more information on any of the topics covered in this issue or how they may impact your business, please reach out to the authors listed with the articles or any of the EY Global Trade professionals listed in the contacts section of the magazine. We also welcome your feedback and suggestions for future editions.

Electronic customs filing

This article deals with real-world considerations for designing and implementing a leading-class solution for electronic customs filing, often referred to as e-customs filing. E-filing is evolving and continuing to replace traditional paper-based filing around the world. Many customs agencies have implemented electronic filing systems to streamline the process and enhance efficiency, making it easier to conduct business in their countries.

Benefits of e-customs filing

E-customs filing offers significant financial and operational benefits for businesses, including:

- **Reduced processing times and delays:** Electronic filing reduces the time needed to prepare and process customs declarations manually by automating the process, leading to faster clearance of shipments by customs agencies.
- **Cost savings:** Automating customs filing reduces or eliminates the need to manually generate paper-based declarations, which allows businesses to save on administrative, printing and document storage costs. Companies can also reduce brokerage fees by automating the process and sending data to service providers electronically vs. having them perform the entire process using their own people and technology resources.
- **Improved accuracy:** Manually generated paper-based declarations are resource intensive, time consuming and error prone. By automating customs filing processes companies reduce the time and risk of human error in data entry, ensuring more accurate and reliable information is submitted to customs agencies. This accuracy element also may aid the use of duty-reduction mechanisms. For example, errors in import or export declaration can impact the use of duty drawback or free trade agreement preferences. Removing human error, whether within the company or with the customs broker, provides a better foundation for tariff planning. E-filing may also facilitate post-entry corrections and reconciliation of transfer pricing adjustments.
- **Streamlined compliance:** Electronic customs systems and processes often include capabilities that help businesses comply with various international regulations, such as automating the calculation of duties and integrating screening for export and import controls, licenses, sanctioned parties, and embargoes.
- **Better data management:** Electronic filing creates a data trail for internal and external auditing, making it easier for companies to track and manage customs documentation and associated revisions and resubmissions. E-filing also aggregates data to perform data analytics identifying risks and opportunities as well as enabling use of key performance indicators (KPIs) and metrics.

These benefits and others make e-customs filing a viable option for businesses looking to streamline and optimize their import and export processes.

Challenges

While e-customs filing offers many benefits, it also comes with challenges:

- **Technical issues to consider:** Implementing and maintaining e-customs filing systems and processes can be complex and costly. Technical issues or system outages can disrupt the filing process. Therefore, companies should thoroughly and methodically plan their implementation projects and develop contingency plans for systems outages as part of their cutover and post-go-live plans.
- **Process standardization:** Countries have varying standards and requirements for e-customs filing, making it difficult for businesses to comply with multiple agency and system requirements. Companies should take a global template approach that allows them to standardize their filing program and processes as much as possible, while recognizing there may be a need to localize a standard process for a specific region or country.
- **Training and solution adoption:** Adapting to new technologies can be challenging, especially for smaller businesses. Businesses need proper training and knowledge transfer to use automated customs filing systems effectively. Having an effective change management strategy and plan is critical for a successful launch, adoption, and sustainable program and processes.
- **Integration with other systems:** Integration of data from multiple sources, sometimes including parallel legacy systems, is one of the biggest challenges in implementing e-customs filing systems. Business systems such as procurement and transportation management need to integrate seamlessly with enterprise resource planning (ERP) and global trade management systems. Lack of integration and timeliness of data availability can lead to inefficiencies and processing errors. It is also important to ensure that the master and transactional data required for e-customs filing is available, accurate and retrievable from source systems so businesses can aggregate the data into their customs filing system.
- **Regulatory compliance:** Keeping up with changing rules and regulations that drive customs filing requirements while maintaining compliance can be challenging, especially when dealing with multiple jurisdictions. To deal with this, companies should develop a sustainment plan and checklist to identify and schedule periodic maintenance and review of their filing system and processes. Options for incorporating into the plan include, but are not limited to, customs rules and regulations review; third-party customs and content updates, if used as part of your filing process; product attributes (e.g., export control classification number (ECCN), harmonized tariff schedule (HTS); certificate of origin (COO)); and software updates, patches, and fixes to keep the system performing at its optimal pace.

Despite these challenges, the benefits of e-customs filing, such as cost savings, faster processing times and reduced paperwork, usually outweigh the difficulties.

Preparing for a project

Preparing for e-customs filing implementation involves several key steps to ensure a smooth transition and compliance with varying rules and regulations:

- **Understand the business requirements:** Be familiar with the specific e-customs requirements of the countries the business trades with. Each country may have different standards and regulations that will impact the global template and localization approach.
- **Invest in technology:** Implement the necessary software and hardware to handle e-customs filing. This might include global trade management or customs management software that integrates with existing systems. A best practice is to leverage investment in global trade management (GTM) software to enable this process if it includes e-customs filing functionality.
- **Change management and training:** Ensure that staff are well-trained in using the new systems. This includes understanding how to submit electronic declarations and how to troubleshoot common issues. Also, create and use business process documentation and desktop reference materials to help system users adapt to the system to perform their day-to-day job and responsibilities.
- **Data management and reporting:** Maintain accurate and up-to-date records of all transactions. Good master data governance is crucial for compliance and efficient processing. Having operational reports, metrics and KPIs on system and process performance is also important to provide visibility into operations and processes, and it can help sustain the system and continuously improve the filing program.

- **Engage with customs authorities:** Establish a good relationship with customs authorities. They can provide guidance and support during the transition and will play a key role in the testing of your system as the business implements and deploys it.
- **Pilot testing:** Conduct pilot tests to identify and resolve any issues before fully implementing the system. This helps ensure that everything works smoothly when it goes live.
- **Stay updated:** Keep abreast of any changes in customs regulations and technology. This will help the business remain compliant and take advantage of new opportunities.

By following these steps, businesses can better prepare for the shift to e-customs filing and enjoy the benefits of a more efficient and streamlined process.

Reducing risk

Implementing an e-customs filing system and program can be a complex process, and there are several common risk factors to avoid in order to have a smooth transition:

- **Inadequate planning:** Failing to plan thoroughly can lead to unexpected issues. It's crucial to have a detailed implementation plan that includes timelines, milestones, responsibilities and contingency measures.
- **Poor data quality:** Inaccurate, incomplete or untimely data can cause delays and compliance issues. Ensure that all data entered into the system is accurate and up-to-date. Also, design and implement a system that maximizes default data that flows into a customs filing transaction to minimize or eliminate the need for manual data entry by system users.
- **Lack of training:** Without proper training, staff may have challenges to use the new system effectively. Invest in comprehensive training programs to ensure everyone is comfortable with the new processes.

- **Resistance to change:** System users may resist new systems due to fear of the unknown or comfort with processes to which they've become accustomed. Address their concerns through transparency, clear communication, use of standard operating procedures and desktop reference materials. Highlighting the benefits of the new system and how it will make their job more efficient and effective will also help users throughout the cutover to a new system.
- **Insufficient or inadequate testing:** Eliminating or speeding through the testing phase of your project can lead to catastrophic results once the business operationalizes and goes live with the program and processes. Perform thorough testing to identify and resolve critical defects and issues before full implementation. Develop test scenarios and scripts that are based on real-world scenarios and incorporate positive and negative tests into test plans.
- **Failing to identify or ignoring regulatory changes:** Customs regulations can change frequently. Stay informed about any updates to ensure ongoing compliance.
- **Integration issues:** Ensure that the electronic filing system integrates seamlessly with other internal systems, such as ERP, transportation management, inventory management and other business systems needed to enable the filing processes.

By being aware of these pitfalls and taking proactive steps to address them, businesses can better navigate the complexities of an e-customs filing implementation.

Change management

Implementing e-customs involves significant changes, and effective change management is crucial for a smooth transition. Here are some practices to consider:

- **Engage stakeholders early:** Engage key stakeholders early and often to gain their support and address their concerns. This includes management, employees and external partners, such as customs brokers. This should include the tax department, due to the potential impact on customs valuation. Ensure customs brokers are involved in the project planning process so that they have the resources, bandwidth and commitment to meeting the dates and milestones laid out in the project timeline.
- **Clear communication:** Maintain open and transparent communication throughout the process. Regular updates on progress, challenges and successes help keep everyone informed and engaged.
- **Training and support:** Provide comprehensive training and ongoing support to ensure everyone is comfortable with the new system. This can include workshops, online tutorials and help desks.
- **Pilot testing:** Conducting pilot tests to identify and resolve any issues before full-scale implementation is beneficial to confirming that there is a fully enabled and working system prior to full go-live across the technology and business landscape. This helps ensure that the system works as expected and allows for adjustments based on feedback.
- **Monitor and adjust:** Stay in touch with the project team and continuously monitor the implementation process. Be prepared to make adjustments to maximize the system's potential. This includes gathering feedback and addressing any issues that arise promptly.
- **Celebrate successes:** Recognize and celebrate milestones and successes to maintain momentum and to uplift stakeholder morale. This reinforces the positive aspects of the change and encourages continued support for the initiative.

By following these practices, businesses can navigate the complexities of e-customs implementation more effectively and promote a smoother transition.

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Back to Welcome

Recent trends in life sciences – impact on the global trade function

Over the last decade, there has been a shift away from the relaxation of global trade barriers toward the re-imposition of higher import taxes (including imposition of additional duties and taxes to counter trade disputes between countries) and an increasingly complex regulatory framework at import (due to factors including heightened geopolitical tensions and the implementation of sustainability measures). This shift has led to a rise in the significance and complexity of how companies operate to manage import duties and other indirect taxes that are collected at international borders, as well as satisfy increased regulatory and other governmental agency requirements.

Our EY Global Trade team in Ireland has led a Global Life Science Strategic Trade Forum since 2006 that has, at the heart of its objectives, the goal to bring together trade experts from leading companies in the sector to collaborate and foster insightful dialogues. The forum has created a platform to drive conversations around compliance, strategy and the impact of geopolitical trends on the life sciences industry. This article aims to share some of those key insights and trends, drawing from recent discussions, think tanks, and benchmarking outputs gathered from this community's collaborative efforts.

For the life sciences industry specifically, there has been a noticeable increased focus on the substance and structure of the global trade function, with a primary emphasis on safeguarding compliance with regulations to help ensure timely delivery of products to patients, while at the same time reflecting the need to manage international trade costs due to an increased focus on margins amid financial pressures in the sector. We explore below the scope and breadth of the trade function globally, its broader organizational impact, and the primary objectives that it should aim to achieve.

Recently, global trade teams in life sciences companies have shifted much of their resources toward navigating increasingly complex, fast moving and stringent export controls. These controls are a central aspect of a broader regulatory framework that includes ensuring compliance with health and safety standards, obtaining necessary product licenses, and screening of suppliers and goods. Companies must navigate these complexities while also adhering to environmental, social and governance (ESG) principles, including sustainability measures like the Carbon Border Adjustment Mechanism (CBAM)[1] and the European Union (EU) Deforestation Regulation (EUDR).

1 For further information on CBAM, please refer to articles in previous edition of *TradeWatch*. Find them here.

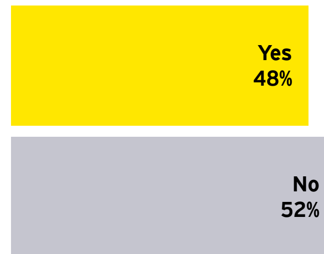
Impact on the global trade function

The reporting structure of the global trade function within life sciences organizations is a topic of ongoing debate. There are no one-size-fits-all conclusions. Key trade policy developments (ESG initiatives, increased tariff barrier disputes (US-China, EU-China), geopolitical tensions) have prompted companies to reassess the optimum placement for the trade function in their organization (e.g., tax, supply chain, legal, finance).

Benchmarking within the life sciences sector, based on an analysis of 30 top companies located around the globe, indicates a consistent level of dedicated trade personnel, with most companies maintaining a team of up to 50 individuals. Compliance is the cornerstone of the trade function, with management of export controls and sanctions requirements emerging as critical areas due to the impact of events such as the Russia-Ukraine war. While cost savings are considered, the primary emphasis is on achieving operational excellence and efficiency, ensuring that products meet quality standards and reach the market without delays.

In the past, it is fair to say that many global trade functions within the sector may have been characterized as reactive, focusing on battling fires rather than focusing on processes and strategic planning. Our most recent benchmarking results indicate a shift in focus, with activities now split between tactical and strategic. The trade function is increasingly tasked with operating on a global scale having dedicated regional trade leaders to enhance global trade outcomes and ensure efficient resource utilization as well as carrying out efficient operational activities at site level. Our latest benchmarking data reveals that more than half of the life sciences companies employ regional trade leaders, and a significant 93% believe it is a best practice for these regional leaders to report directly into the global trade team leader. Additionally, there is wide recognition of the importance for a global trade team leader to be operating at the level of director or above to be most impactful in their activities.

Do you have regional trade leaders in the four main regions (i.e., Americas, EMEA, APAC and LATAM)?

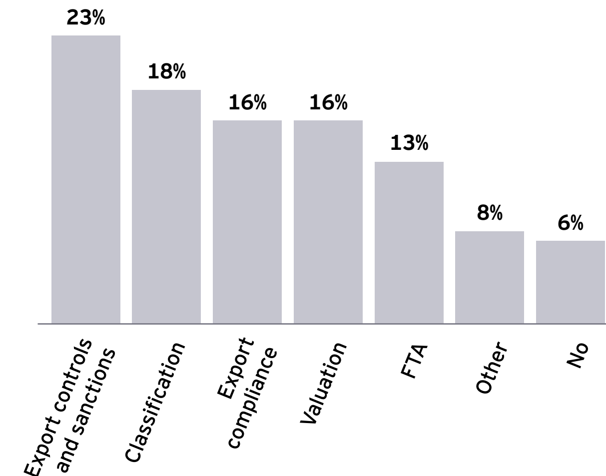


Do these regional trade leads report directly to you?

Based on a survey of 29 companies who attended the Global Life Science Strategic Trade Forum in Dublin on 14 and 15 September 2023.

Do you think it's best practice to have regional leads as direct reports?

Do you have individuals in your global team focused on specific subject matter areas?



Sanctions and export control

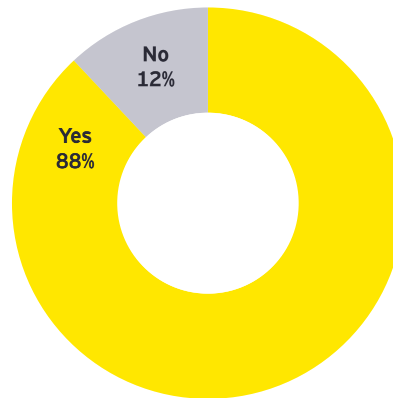
The sanctions imposed on Russia have placed significant strain on trade teams within the life sciences industry, requiring swift adjustments to new regulations and a shift in resource allocation. Trade professionals, including those without prior experience in export controls, have had to rapidly familiarize themselves with the latest requirements to support their organizations. Those without specialized export control personnel have had to invest time and resources to understand these regulations. Consequently, there is an increased emphasis on export controls and sanctions within trade teams.

Previously, businesses in this sector were mainly focused on adhering to US export control and economic sanctions regulations, but now they must strategically reassess their approach due to the growing complexity of EU and international sanctions. The industry recognizes that these measures are likely to remain and become more intricate amidst ongoing geopolitical tensions. This evolving scenario necessitates a more comprehensive and specialized expertise to mitigate all associated risks effectively.

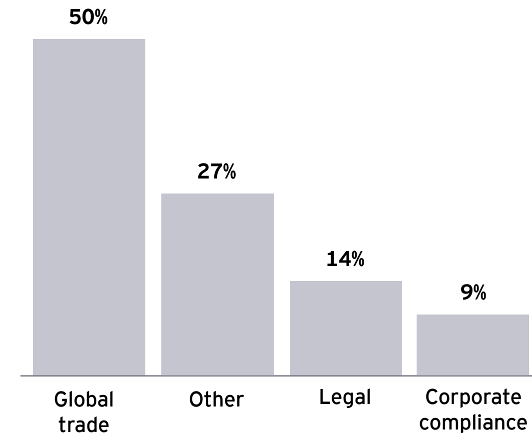
The recent enforcement of EU Directive (EU) 2024/1226,[2] which imposes criminal penalties for sanctions violations, has triggered an urgent recruitment of qualified personnel, especially within the EU. Yet, the market faces a notable scarcity of individuals with the requisite experience to satisfy the increasing demand.

Benchmarking insights indicate that companies with dedicated export control personnel are confident in their expertise and are focusing on trade automation as a strategic component in their export control and screening management processes.

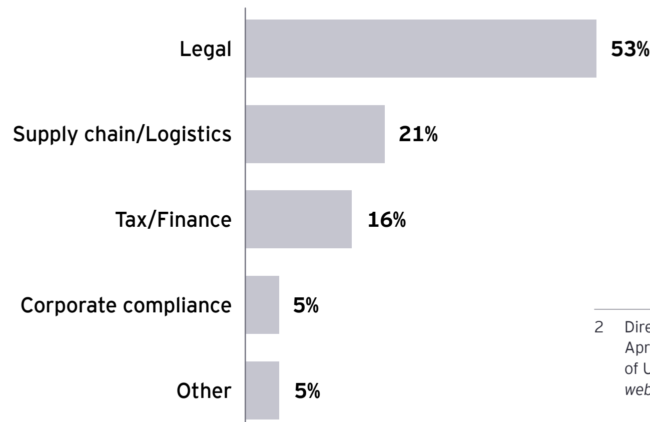
Do you have a dedicated function/person(s) responsible for export controls?



Which function within your organization is responsible for monitoring changes related to sanctions and export controls regulations?



Do you have a touch point/escalation for changes related to sanctions and export controls regulations into other departments?



2 Directive (EU) 2024/1226 of the European Parliament and of the Council of 24 April 2024 on the definition of criminal offences and penalties for the violation of Union restrictive measures and amending Directive (EU) 2018/1673, *EUR-Lex website*. Find it here.

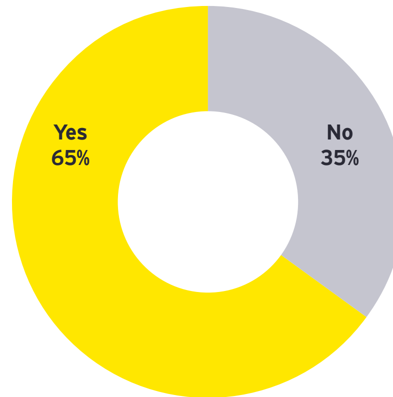
New licensing requirements

With the introduction of new sanctions and regulatory measures, companies have experienced a surge in the number of licenses they need to acquire, particularly for exporting medical products to Russia. This increase in license applications is a direct response to the tighter controls imposed by governments to regulate trade with Russia more strictly.

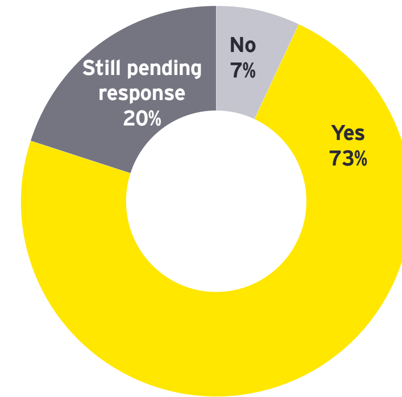
The process of obtaining these licenses has become more complex and time-consuming, as companies must navigate through an expanded set of requirements and provide detailed documentation to justify their export activities. As a result, companies have had to allocate more resources to ensure compliance with these new licensing requirements. This includes dedicating staff to manage the application process, investing in compliance training, and sometimes seeking external expertise to navigate the complexities of the regulatory environment.

The heightened scrutiny on exports to Russia means that companies must also be prepared for potential delays in obtaining licenses, which can impact their operations and lead to increased costs. This has made it essential for companies to plan ahead and incorporate these considerations into their trade strategies to minimize disruptions to their business.

Has your organization applied for licences or authorizations from the appropriate regulatory agency to export goods to Russia?

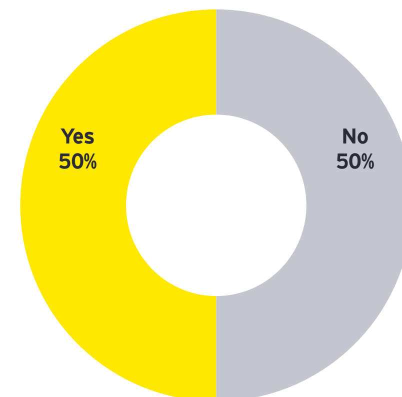


Were those licences/authorizations to export to Russia granted to your organization?



Is your organization aware of procedures to obtain licenses/authorizations to export goods to Russia?

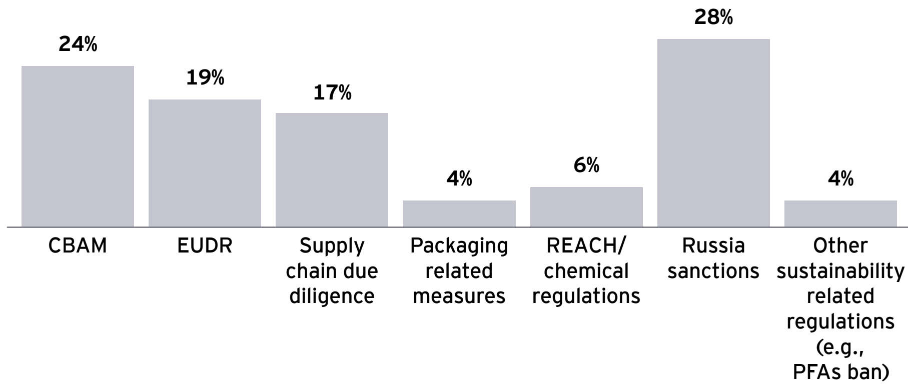
Were any of those licences/authorizations rejected/ returned for additional information?



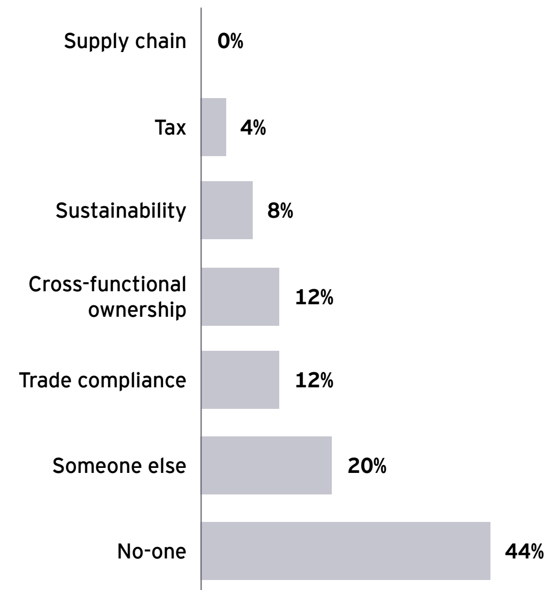
Sustainability

Global trade in life sciences is increasingly influenced by sustainability regulations, with CBAM, Forced Labor, and EUDR initiatives posing significant challenges for companies in the sector. The uncertainty surrounding the ownership of compliance responsibilities within organizations is a primary concern. Traditionally, departments such as environmental health and safety (EHS), sustainability, compliance, or supply chain might be considered for this role. However, the complexity of these regulations requires a more integrated approach, often involving multiple departments and the trade function serving as a subject- matter expert due to its understanding of import and export flows.

What are the biggest sustainability-related concerns for you at present? (3 max)



Which department in your business is responsible for CBAM?



CBAM

For the life sciences industry, the current scope of CBAM affects aluminum films, which are commonly used in packaging and equipment. Additionally, manufacturers need to be aware that machinery may also fall under CBAM regulations. The scope of covered goods is expected to expand by 2026 to potentially include plastics and polymers, with the aim of aligning with the European Union's Emissions Trading System (ETS) and bringing all relevant goods into scope by the end of 2030.[3]

With companies already having submitted their first three quarterly CBAM reports, life sciences companies must focus on the next steps in their sustainability compliance journey. The ultimate goal that will require companies to report on the actual embedded emissions of imported goods (including calculations based on a comprehensive account of both direct and indirect emissions, as well as any carbon costs incurred in third countries) will be a significant additional reporting obligiation. Data gathering for compliance has already been highlighted as a key requirement but it may be difficult to source. Such data is required for accurate tracking of emissions and supply chain practices. Building a dedicated team or enhancing the capabilities of existing teams to manage these data requirements is essential for compliance and for making informed decisions on sustainability.

EUDR

EUDR represents a significant step in the EU's commitment to combating climate change and promoting sustainable trade practices. This regulation aims to minimize the EU's contribution to global deforestation by ensuring that products entering the EU market have not been produced on deforested or degraded land after 31 December 2020. It requires companies to exercise due diligence in their supply chains to verify the legality and deforestation-free status of commodities and products such as soy, beef, palm oil, wood, cocoa, rubber and coffee, as well as derived products.

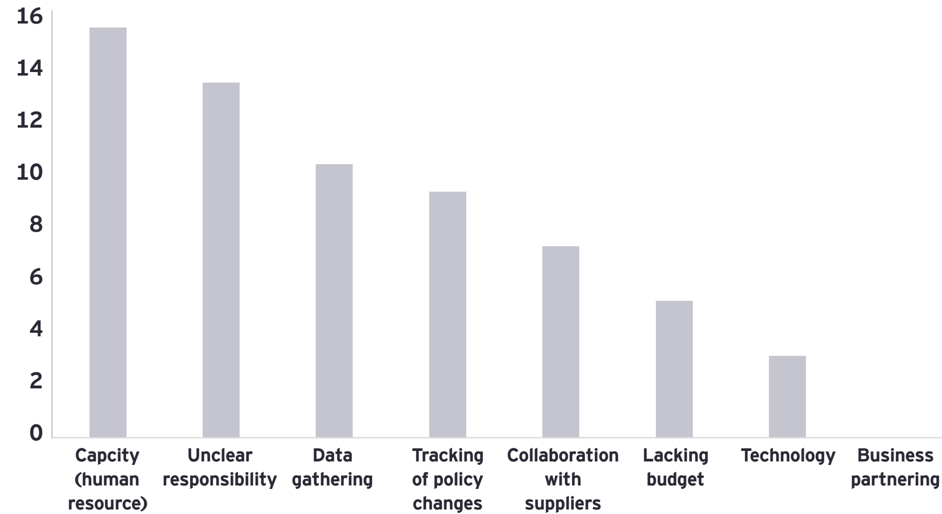
For global trade professionals, EUDR introduces an additional layer of scrutiny and responsibility. While the direct impact on the sector may seem limited at first glance, as the primary commodities listed are not typically associated with pharmaceuticals or medical devices, the regulation's broader implications cannot be ignored. Life sciences companies often rely on a diverse range of raw materials and derivatives, some of which may be subject to the regulation either directly or through their supply chain connections. For instance, palm oil derivatives are commonly used in the production of some medications and personal care products, which could fall under the scope of the regulation.

3 "EU: Final regulations published for new CBAM and ETS revisions", *TradeWatch* Issue 2 2023, page 36. Find it here.

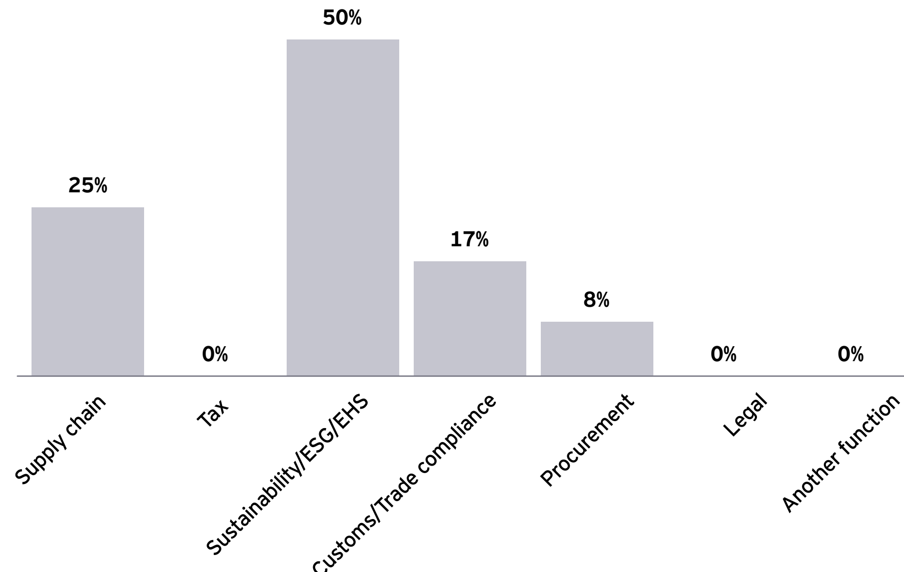
Our recent poll identified the top three concerns about the EUDR:

1. **Lack of capacity:** This limits companies from performing the necessary impact assessments to monitor transactions potentially affected by the regulation and, more importantly, the ongoing need to complete due diligence statements for each relevant commodity traded. This step is crucial for life sciences companies, as these statements are mandatory for import and export activities. Failure to provide them could result in goods being stopped at borders, a critical issue for certain products, e.g., those that are temperature sensitive. Moreover, there will be a need for qualified personnel to conduct due diligence to assert a "negligible risk" in these statements, which is a requirement set by this regulation.
2. **Unclear responsibility:** 75% of respondents in our latest poll indicated sustainability or supply chain as the function responsible for EUDR compliance. In practice though, it often falls to global trade teams to prevent goods from being detained at customs.
3. **Challenge of data gathering:** Particularly acquiring specific geolocation coordinates where commodities were harvested or produced, which is also a requirement set by this Regulation.

Which of the following are the key challenges for you? (3 max)



What business function owns EUDR?



The regulation thus compels life sciences companies to conduct thorough assessments of their supply chains, ensuring that their sourcing practices do not contribute to deforestation. This may involve re-evaluating supplier relationships, investing in traceability technologies, and potentially restructuring supply chains to meet the EU's stringent standards. As a result, EUDR not only affects trade dynamics by imposing new compliance requirements but also encourages the life sciences sector to adopt more sustainable and transparent business practices, aligning with broader ESG objectives.

Summary

The global trade environment for the life sciences sector is rapidly changing due to geopolitical shifts, tougher regulations and a stronger focus on ESG responsibilities. The complexity of new rules has made it crucial for businesses to carefully manage their trade practices and comply with regulations. The collective insights as summarized above illuminate the path ahead and play a key role in helping companies navigate these challenges by sharing insights and best practices. The industry is moving toward a more strategic approach to trade, with a focus on compliance, efficiency and sustainability. As companies face new regulations, complexities of export controls and sanctions and strive to meet sustainability goals such as CBAM and EUDR, the role of the global trade function has never been more important. As the sector evolves to meet the demands of an ever-changing global landscape, the commitment to compliance, operational effectiveness and supply chain integrity remains steadfast. ■

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Back to Welcome

Life sciences: Addressing the impact of evolving export controls and sanctions

The life sciences industry is a complex and dynamic sector, encompassing pharmaceutical, biotechnology, medical and other companies related to health care and biological sciences.[1] As technological advancements and increasingly sophisticated global supply chains characterize this dynamic industry, risks related to global export controls and sanctions are increasingly in play, creating new challenges and risks in a field that has historically been less impacted relative to the technology, aerospace and defense, and advanced manufacturing sectors.

Around the world, trade compliance risks have never been higher. The start of the Russia-Ukraine war in February 2022 triggered massive changes in export controls and economic sanctions rulemaking and enforcement in the US and abroad. The original focus was Russia, but it quickly broadened. Waves of escalating regulatory changes, in parallel with coordinated enforcement, impact all industry sectors. Some have been specifically targeted, such as semiconductors and advanced computing. But for other sectors, including life sciences, the challenges stem from the interplay between such changing trade rules, supply chains established before the abrupt shift from globalization to quasi-polarization, and industry advances in technology.

Trade compliance programs should be fit for risk. The higher the risk – likelihood of impact, magnitude of consequences – the greater the need to verify that the trade compliance function has the right people, processes, systems and governance model to achieve corporate objectives. Companies with adequate trade compliance programs for their risk profile in 2021 now find their programs are no longer sufficient to maintain supply chain continuity, ensure business right-to-operate, reduce customs duties and taxes, and foster compliance.

This article covers how industry changes and evolving export control, economic sanctions and other trade rules have increased risks in the life sciences sector – and what companies can do about it. While the focus is on pharmaceutical, biotechnology, medical and other companies related to health care and biological sciences, many of the challenges and responses will resonate with trade practitioners in every sector.

Evolving export control risks

Export controls have always been relevant to life sciences companies. Export control restrictions have longstanding application to certain human, animal

1 Please also refer to our article "Recent trends in life sciences – impact on the global trade function" on page 7 in this edition.

and plant pathogens and agents (US export control classification numbers (ECCNs) 1C351, 1C352 and 1C354), related genetic elements (US ECCNs 1C351–4), related vaccines and testing kits (US ECCNs 1C395 and 1C991), biological processing equipment (e.g., US ECCN 2B352),[2] and related technology (e.g., US ECCNs 1E001, 2E001, 2E002 and 2E301).

These historical export control risks have expanded due to recent industry and regulatory changes that increasingly impact the entire product lifecycle.

Increased use of export-controlled materials as part of drug products impacting the entire product lifecycle

Advances in technology have led to new therapeutic modalities where a late-stage component used in creating, or as part of, the active pharmaceutical ingredient (API) is export controlled. Similar concerns apply to medical devices.

For example, pharmaceutical companies may have APIs that are export controlled across numerous therapeutic areas:

- **Small molecules:** With some modern medicines the API itself may be export controlled. A particularly interesting example is the use of export-controlled deuterium in producing deuterated medicines (explored in the case study opposite).
- **Biologicals and large molecules:** Export-controlled genetic sequences, plasmids and vectors related to controlled pathogens are being used to fashion treatments for uncontrolled pathogens. While the finished drug product may not be controlled, all earlier stages of development and product manufacture may be subject to stringent export controls.
- **Radiological components:** There are both historical and emerging treatment modalities that involve the application of radiation. Here, too, the finished drug or device may be subject to complicated regulatory controls spanning the entire supply chain.

In such cases, export controls are relevant at every stage of the product lifecycle —research, development, clinical studies, manufacturing and distribution. A failure to identify and resolve export controls risk at any stage impacts all subsequent business operations and even patient outcomes.

For example, clinical trials may pose export control and sanctions risks due to the global nature of their administration and footprint: A single clinical trial may span dozens of countries, each with its own export control and licensing requirements applying not only to the end product itself but to kits, samples, and the equipment and technology used to administer the trials and record data. A failure to identify export-controlled goods, software and technology may lead to unexpected delays or even complete stoppage.

Case study – deuterated compounds

Deuterium is a chemical element that can be used for many purposes, from nuclear to medicinal uses. A stable isotope of hydrogen with a neutron in its nucleus, deuterium is a key material in nuclear applications, specifically as a neutron moderator in nuclear reactors and as a fuel in nuclear fusion. While deuterium itself can be associated with nuclear power or nuclear weapons production, it is not itself radioactive.

Medical applications of deuterium or deuterated compounds have exploded with technological advances in medicine and pharmaceuticals. Deuterium can be used to create deuterated versions of existing drugs and pharmaceuticals, increasing the effectiveness of certain medications by enhancing the drug's metabolic stability and pharmacokinetic properties (i.e., the drug's absorption and distribution within the body).

Due to historic and existing nuclear applications of deuterium, the element and its compounds have been highly controlled for nuclear end uses in support of nuclear nonproliferation. Since 2021, the US has bifurcated two different sets of export control rules for civilian-used deuterium: Deuterium and deuterium compounds for use in a nuclear reactor are controlled by the US Nuclear Regulatory Commission (NRC), while deuterium and deuterium compounds used for civilian non-nuclear reactor end uses are controlled by the US Department of Commerce Bureau of Industry and Security (BIS). Depending on facts and

2 Examples of biological processing equipment controlled under US ECCN 2B352 may include centrifugal separators, clean rooms, cross-flow filtration, freeze-drying and spray-drying equipment, fermenters, positive-pressure protective suits, aerosol challenge chambers, and Class III safety cabinets.

circumstances, an export license may be required by either agency. Many other countries follow a similar model.

Deuterated medicines are, technically, compounds featuring deuterium. Even though they are not readily capable of nuclear end use like other deuterated compounds (such as heavy water), the regulatory framework employed by most countries was not designed with such a distinction. So far, regulatory and licensing carve-outs for medical end uses of deuterated compounds have been slow to manifest in most countries, including the US, making the finished drug product potentially subject to import and export controls.

China is a notable exception. China has specific medical-use classification for certain deuterium compounds used for treating certain diseases, such as Huntington's disease. As advances in medical uses for deuterium and other highly controlled compounds accelerates, other countries may see this trend as jurisdictions and regulatory frameworks keep pace with emerging technologies.

Increased export control risks for life sciences R&D

Research and development (R&D) in the pharmaceutical and life sciences industries often involve highly controlled toxins, viruses, chemicals, equipment and technology that are subject to strict licensing requirements for export to most countries. Life sciences companies should be aware that in many cases, it is not just the specific virus, toxin or biologic that is controlled and thus requires a license; related technology, and certain types of discrete lab equipment, software and technology, may also be controlled.

Due to national security concerns, controls on life sciences technology are subject to current regulatory focus. For example, in early 2023, BIS expanded controls under US ECCN 1E001 to include technology for the development or production of specific marine toxins controlled under US ECCN 1C351.d.

Changes in export controls may be aligned with more universal research, discovery and development and not just specific pathogens, agents or toxins. Recent unilateral (e.g., US Section 1758) and multilateral (e.g., Wassenaar Arrangement) inquiry or rulemaking areas have included nucleic acid assembler and synthesizer software that is capable of designing and building functional genetic elements from digital sequence data, instruments for the automated chemical synthesis of peptides, and certain brain-computer interface technologies.

Export-controlled technologies impact research, discovery and development. Increased international collaboration and offshoring R&D activities result in employees from different countries sharing and exchanging information or technology that may be controlled. Additionally, shipments and exchanges between countries of export-controlled samples, prototypes and the like may run the risk of going undetected by companies as they are viewed as noncommercial shipments. Collaboration in international environments poses deemed export risks, where a license is required to share information or software related to a controlled item to a foreign national in the same way a license would be required to physically ship a controlled item to another country.

Any multinational R&D operation in any sector may face these types of risks, but life sciences companies in particular face a further complication. At most life sciences companies, research, discovery and development activities typically rely on isolated

systems and processes that make it hard to deploy traditional trade compliance controls, whether automated or manual. In addition, laboratory procurement and shipping often does not occur on the primary enterprise management systems The processes and systems used may vary by lab or therapeutic area. This makes implementing effective internal controls harder than in most other industries.

Increased economic sanctions and other trade risks due to geopolitics

Economic sanctions are restrictive measures imposed by governments to advance foreign policy and national security goals. While export controls are generally focused on movement of goods, software and technology, economic sanctions generally restrict interactions with countries, their governments, targeted sectors and/or their entities.

Unlike most industries, life sciences companies enjoy the possibility of obtaining general or specific export control and/or economic sanctions authorizations to sell and support non-controlled medicines and medical devices even to comprehensively sanctioned countries (assuming that they have adequate trade resources for licensing and transaction diligence).

Even so, life sciences companies are impacted by evolving sanctions and geopolitics. Pharmaceutical companies performing clinical studies in Russia during 2022 would have been impacted by iterative export controls and economic sanctions issued on short notice. Medical device providers selling to Russia would have had to quickly respond to successive rounds of new regulations impacting each area of the lead-to-cash pathway.

Similarly, life sciences companies operating in China face new and future geopolitical risks.

China plays a prominent role in biotech and API production, meaning that further geopolitical tensions between the US and China could disrupt supply chains. For example, in 2024, US lawmakers have considered a bill restricting business with certain Chinese biotech companies on alleged national security grounds. As another example, in September 2024, the US significantly raised current and/or prospective tariffs on face masks, medical gloves, syringes and needles sourced from China. The US Trade Representative opined that "increasing Section 301 duties on certain personal protective equipment will help protect recent investments in increasing domestic production and in US preparedness."[3] Two months prior, in July 2024, BIS[4] announced that it will be conducting a comprehensive assessment of the US API industrial base that will ultimately be used "to help ensure the availability and security of the API supply chain and to raise awareness of current limited domestic manufacturing capabilities, among other potential issues."

The above examples are merely illustrative and do not fully reflect the complicated intersection of the life sciences industry with economic sanctions or geopolitics in general, or with Russia or China in particular. Nonetheless, they demonstrate why economic sanctions, geopolitics and trade remedies are an important aspect of supply chain planning.

Increased export controls and economic sanctions risks due to increased enforcement

In recent years, the US and other governments have significantly ramped up enforcement of export controls and economic sanctions, reflecting a strategic shift toward tighter regulation of export controls and sanctions as matters of national security. This new enforcement trend includes coordinated investigations, higher civil penalties and more criminal prosecutions. In 2023, the US Departments of Justice and Commerce, working in collaboration with the Federal Bureau of Investigation and Homeland Security Investigations,

3 "Notice of Modification: China's Acts, Policies and Practices Related to Technology Transfer, Intellectual Property and Innovation," Office of the United States Trade Representative, 89 Fed. Reg. 76581, 76585, 18 September 2024. Find it here.

4 "BIS To Conduct Assessment Of U.S. Active Pharmaceutical Ingredient Industrial Base," *BIS website*, 9 July 2024. Find it here.

launched the Disruptive Technology Strike Force to investigate and prosecute export control, economic sanctions and espionage matters. US regulators began aggregating their data to target investigations. Similar coordinated investigation and enforcement activity is already occurring between the US and its allies. In September 2024, BIS created a new Chief of Corporate Enforcement role foreshadowing future enforcement activities.[5]

Enforcement efforts have begun to impact the life sciences sector in interesting ways. A 2023 resolution involving Iran sanctions featured a USD175,000 settlement with an individual former senior executive in addition to the corporate settlement. In 2024, the US Department of Justice declined criminal prosecution of export control violations by a pharmaceutical company based on the actions of internal trade compliance personnel. A 2024 settlement with a US university involved a suspended one-year loss of export control privileges for controlled biologicals pending remedial activities. Failure to comply would effectively shut down international research involving controlled biologicals for a year. This would be unfortunate for a university but crushing to many life sciences companies.

Actions for businesses

Maintaining a robust compliance and risk assessment program is vital not only for ensuring compliance but also for ensuring sustainable business operations that can directly impact customers and patient outcomes globally.

5 "Commerce Implements Regulatory Changes to Voluntary Self-Disclosure Process and Penalty Guidelines; Names Raj Parekh as First-Ever Chief of Corporate Enforcement," *BIS website*, 12 September 2024. Find it here.

- **Risk assessments:** Frequent enterprise-wide risk assessments facilitate the identification of controlled items or technology as well as associated risk factors related to supply chains and the involvement of third parties or sensitive, high-risk jurisdictions. Risk assessments allow organizations to keep a steady pulse on their risks and opportunities for improvement and prioritization of internal controls to manage risks. For life sciences companies, this risk assessment should recognize the impact of evolving export controls, economic sanctions, geopolitics and trade remedies across the entirety of operations, including sources of API, clinical research organizations and locations, contract management operations and locations, and distribution.
- **Internal controls:** Developing and maintaining robust internal controls relative to enterprise risk is vital for ensuring compliance across large organizations. Documented procedures and integrated steps to check and manage risks for controlled items, including software and technology, can prevent violations before they occur. For life sciences companies there may be a particular need to separately address controls for research, development and clinical operations from commercial manufacturing and distribution activities.
- **Training:** Frequent enterprise-wide and targeted role-based trainings are essential for a strengthened compliance program, cultivating awareness of risks associated with export controls and sanctions relative to their daily tasks and responsibilities. Risks related to laboratory and clinical settings may benefit from integrating export controls content into existing targeted laboratory trainings (biosafety, radiation safety, etc.).
- **Monitoring and auditing:** Monitoring is crucial for a robust compliance program, as it provides insights into the business, its operations and associated risks, which can then be used to strengthen policies, procedures and internal controls. Data analytics and technology-driven solutions can assist in monitoring and auditing compliance programs, which is useful for spotting risk gaps and opportunities for improvements to internal controls and enterprise operations to manage risks. Executives need to recognize that including the trade function in strategic enablement (business and supply chain planning, acquisition due diligence, government relations) is absolutely necessary to ensure supply chain continuity and maintain business right-to-operate in this geopolitical era. ■

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Argentina: RIGI – incentive system for large investments

On 8 July 2024, Law No. 27742[1] was published in the Official Bulletin.[2] Among other matters, it establishes the Incentive System for Large Investments (RIGI, in Spanish) that grants significant benefits, such as for customs and foreign exchange.[3]

Overview of the RIGI system

The purpose of the RIGI is to give those who commit to executing large investments, within a certain period, a degree of predictability, stability, legal certainty and protection for acquired rights in tax, customs and foreign exchange matters. The system grants significant benefits and applies to large investments in projects within the forestry, tourism, infrastructure, mining, technology, steel, energy, and oil and gas sectors without geographical limitation within the Argentine Republic.

Only single-project vehicles (VPUs, in Spanish) that hold one or more phases of a project qualifying as a "large investment" may be part of the RIGI system. VPUs include stock corporations including single-member corporations, limited liability companies and branches established by companies incorporated abroad.

Projects that involve the acquisition, production, construction and/or development of assets that will be affected by activities that meet a series of conditions established in the regulations will be considered large investments if they involve an investment amount per project in computable assets of at least USD200 million.

1 "Law 27742," *Argentina tax authority website*, 8 July 2024. Find it here.

2 "Argentina enacts Bases Law and Tax Package," *EY Tax Alert*, 8 July 2024. Find it here.

3 "Argentina enacts new incentive regime for large investments," *EY Tax Alert*, 12 July 2024. Find it here.

Customs benefits

The RIGI benefits from a customs perspective include:

- **Imports of goods:** Exemption from import duties, the statistical rate and destination verification rate, and from any system of additional withholding, collection, prepayment, or withholding of domestic and/or local taxes for imports of new capital goods, spare parts, parts, components, and consumer goods, and temporary imports.
- **Exports of goods:** Exemption from export duties after three years from the date of adherence for exports of goods for consumption obtained under the promoted project, carried out through VPUs adhering to the RIGI. For those exports declared strategic for the purposes of this system, export duties will begin to be exempt after two years from adherence to the system.
- **Valuation:** Official prices or any other official measure altering the value of imported or exported goods, or supply priorities to the domestic market, shall not apply, even if they are provided for under current legislation on the date of adherence, except where expressly included in the approval by the regulatory authority of the application for adherence and the investment plan submitted.

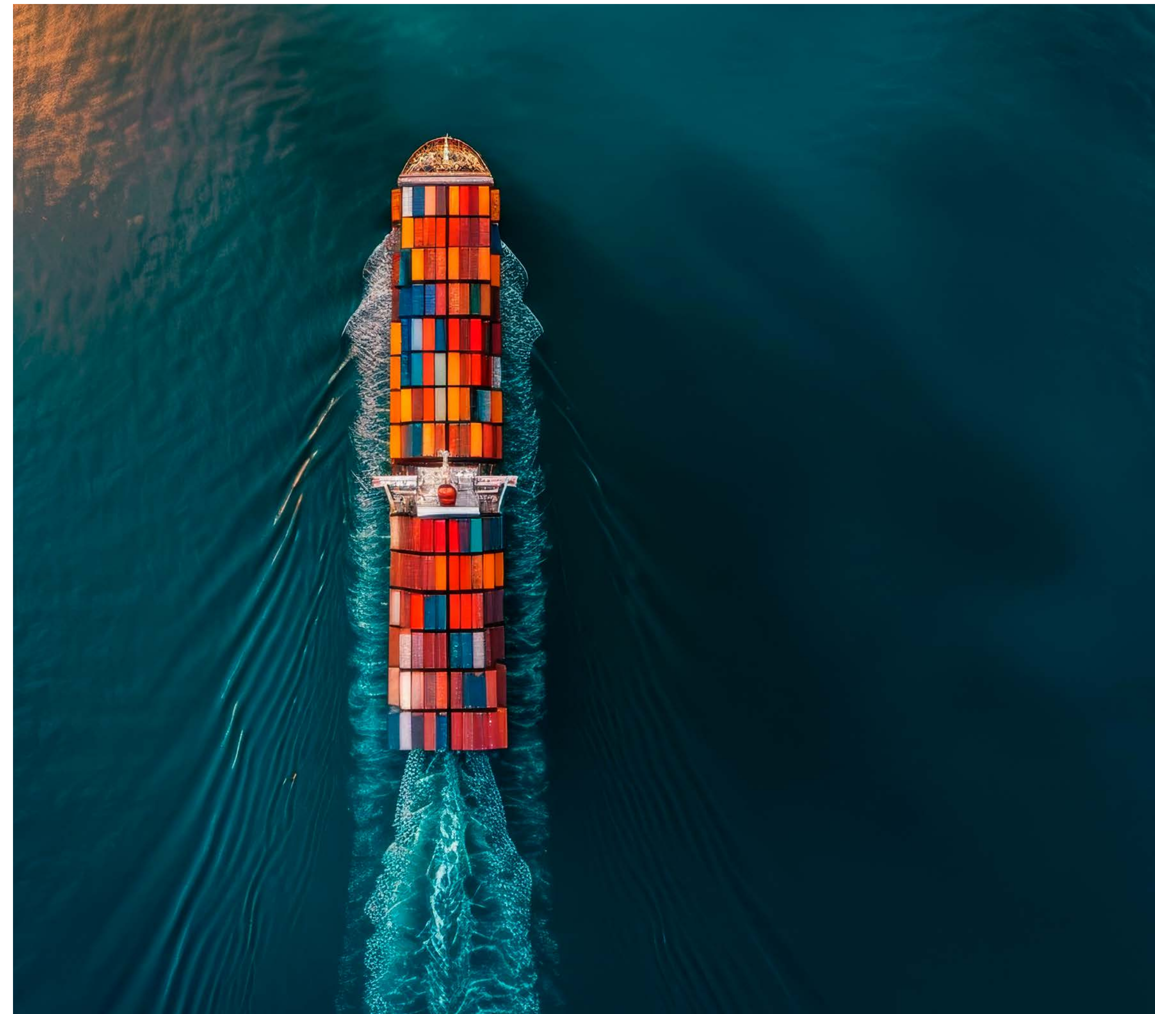
The ownership, possession, holding or use of the benefited goods – except for inputs used in production – cannot be subject to transfer, unless such transfer is made to another VPU adhering to the RIGI, which must be notified to the regulatory authority within 15 calendar days from its occurrence.

Suppliers of goods or services with imported goods may also apply for adherence to the RIGI exclusively for the purpose of obtaining the incentives and rights established in the law regarding imported goods, including inputs. Upon registration, suppliers must comply with certain requirements expressly established in the law, such as billing percentages and submission of sworn statements.

Foreign exchange benefits

The benefits provided for under the RIGI from a foreign exchange perspective include:

- **Export of goods:** The collections from exports of products from the project under the RIGI made by VPUs are exempt from the obligation to enter and convert foreign currency through the foreign exchange market, subject to the following percentages:



- 20% after one year from the date of commencement of the VPU's operations
- 40% after three years from the date of commencement of the VPU's operations
- 100% after four years from the date of commencement of the VPU's operations

  In cases where the VPU is the holder of projects declared as long-term strategic export projects, the exemption to enter and convert foreign currency from product exports will be reduced to two and three years in the second and third points mentioned above, respectively.

- **Other concepts:** The obligation to enter and convert foreign currency through the foreign exchange market will not apply to other items (such as capital contributions, loans or services) related to the project that is the subject matter of the approved investment plan, with full availability thereof.
- **Liquid external assets:** No limitations on the holding of liquid or non-liquid external assets imposed by foreign exchange regulations will apply to VPUs adhering to the RIGI. However, the amount of liquid external assets that VPUs keep abroad may be taken into account by foreign exchange regulations that may establish in the future restrictions or prior authorizations for access to the foreign exchange market.
- **Payments abroad:** Foreign exchange regulations that establish, or may establish in the future, restrictions or prior authorizations for access to the foreign exchange market for the payment of principal on loans and other debts with foreign parties and/or the repatriation of direct investments by nonresident parties will not apply, provided that the amount of foreign currency entered and converted in the foreign exchange market as loans and other debts with foreign parties and/or capital contributions or other direct investments by VPUs is at all times greater than or equal to the amounts in foreign currency intended to be paid abroad.
- **Profits, dividends and interest:** Foreign exchange regulations that establish, or may establish in the future, restrictions or prior authorizations for access to the foreign exchange market for the payment of profits and dividends or interest to nonresident parties will not apply to VPUs, provided that such profits, dividends or interest have been generated by capital contributions or financial loans entered and converted through the foreign exchange market since the adherence to the RIGI.

Tax, customs and foreign exchange stability

VPUs adhering to the RIGI will enjoy regulatory stability in tax, customs and foreign exchange matters with their qualifying projects for 30 years from the VPU's date of adherence.

The benefits are subject to compliance with the terms and conditions established by the RIGI and the relevant controls, which should be evaluated on a case-by-case basis.

The RIGI was regulated by Decree 749 on 23 August 2024. Further regulations may be issued in due course. ■

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4 "Argentina publishes decree implementing Incentive Regime for Large Investments," *EY Tax Alert*, 26 September 2024. Find it here.

Brazil: Tax reform moves to the next stage

The Brazilian tax system has long been recognized as complex and challenging.[1] However, the much-anticipated tax reform, which signals a decisive shift toward simplification and harmonization, was enacted in the form of Constitutional Amendment No. 132/2023[2] at the close of December 2023.

In a further development, in accordance with the new constitutional rules, the Chamber of Deputies approved the Complementary Law Project (PLP, in Portuguese) No. 68/2024[3] on 10 July 2024, which aims to establish new taxes in Brazil.

According to the PLP, the Tax on Goods and Services (IBS), Contribution on Goods and Services (CBS), and Selective Tax (IS) will substitute several indirect taxes that apply in the current system. The project is now under discussion by the Senate. Any changes, or additional provisions made by the Senate, need to be approved by the Chamber of Deputies before they are enacted and come into force.

Current vs. future tax system

Currently, the Brazilian tax system includes various indirect taxes such as the Tax on Services (ISS), the Circulation of Goods and Services Tax (ICMS), the Industrialized Product Tax (IPI) and two social contributions, PIS and COFINS. These taxes apply to a wide range of economic activities carried out daily by taxpayers throughout Brazil, including foreign trade operations.

In this article, we focus on the impact, improvements and concerns that the tax reform may bring to foreign trade operations, especially to the import and export of goods and services, including operations preceding exports.

It is worth noting that all legislation related to import duty (II) and export duty (IE) will not be affected by the tax reform, at least for the time being. Therefore, the tax rates, taxable event, tax base, and tariff reductions for these customs duties should remain as they are currently.

Imports: Currently, indirect taxes are charged on imports in different ways and in different combinations, with many exceptions and differentiated treatments, culminating in a highly complex system. It is not uncommon for competing companies in the same sector to have different tax obligations. This situation creates a very challenging system for importers, who need to heavily invest in controls and potentially need to manage vast amounts of tax litigation.

Exports: Although the Federal Constitution grants exports immunity from these taxes, they still create several effects on the stages prior to export, resulting in problems similar to those mentioned above for importers.

With the tax reform, after the transition period, all current indirect taxes will be replaced by IBS and CBS. However, the bill also proposes the creation of a new

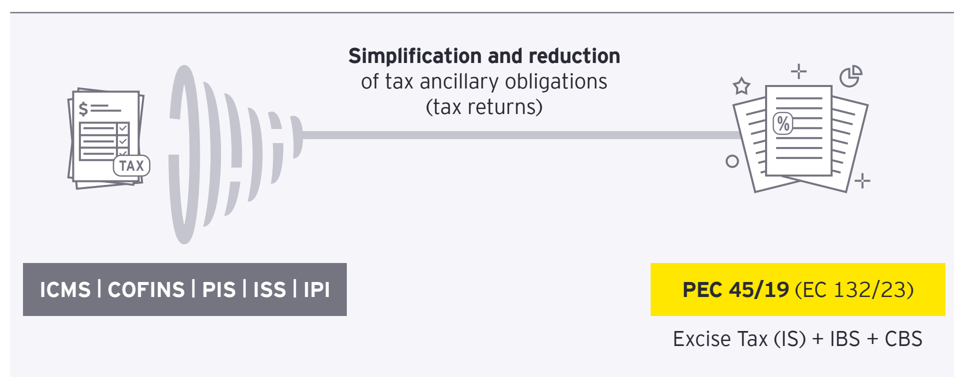
1 "Brazil: Implications of the tax reform on global trade," *TradeWatch* Issue 1 2024, page 31. Find it here.

2 Presidência da República. Constitutional Amendment No. 132. Accessed on 5 September 2024. Find it here.

3 Câmara dos Deputados. Complementary Law Project No. 68. Accessed on 11 July 2024. Find it here.

excise tax, IS, which will be levied in a single phase on the importation of goods and services that may be harmful to human health or the environment. It will apply to items such as tobacco products, alcoholic and sugary beverages, some vehicles, mineral goods, and betting pools and fantasy sports. In these cases, IS will not be eligible for use as a credit in previous transactions or for generating credit for future transactions.

The current and future indirect tax landscape is illustrated below.



Import and export of services and intangible goods, including rights

The two new taxes, CBS and IBS, will apply to the importation of intangible goods, including rights and services, whenever such operations represent a remunerated transaction. This provision is similar to the current regime, as the payment for imported services marks the time when the taxable event occurs for the ISS and PIS/COFINS taxes.

However, there are significant differences including the following:

- **Tax credits:** ISS does not allow for tax credits and for PIS/COFINS credit is only allowed when certain requirements are met (such as the taxpayer being subject to the non-cumulative regime of these taxes and the expense being essential for the company's economic activity). In contrast, CBS and IBS will allow for credits in a much broader way.
- **Tax rate:** The reference combined rate of CBS/IBS, expected to be 26.5%, is much higher than the current combined rates of ISS/PIS/COFINS, which add up to about 14.25%. On the other hand, the final tax burden may be lower for businesses, due to the less restrictive credit allowance permitted under the new taxes.
- **Intangible goods and services:** Taxing the importation of intangible goods, including rights, under CBS/IBS will mean innovating and updating the tax legislation as many of these operations are not taxed by ISS as they are not considered to be services under that legislation. Although the new regime will expand the tax base, it should also simplify various matters that have been under discussion. Many companies currently choose to treat some intangible goods as services to avoid the municipal tax authorities potentially reclassifying these operations as services, based on their legal nature. A recent controversial example was the taxation of imported software, which has now been characterized as a service by the Supreme Federal Court (STF), ending a long dispute on the subject.[4]
- **Services supplied with goods:** Another circumstance that may be simplified is the charge for services whose values are embedded in the value of goods, such as the installation of machines and equipment. In the current system, there are many discussions about these situations, as the import of goods and services are subject to different taxes and applied in different ways. In the new system, both services and goods will be taxed by the same taxes, the same calculation and crediting methodology, and at the same rate. Thus, for IBS/CBS purposes, in calculating the tax charge for services, it will make no difference whether they are embedded in the price of the goods or not. Moreover, if it is unclear which portion of the commercial value refers to tangible goods or to services and intangible goods, the total value will be taxed at the higher rate.

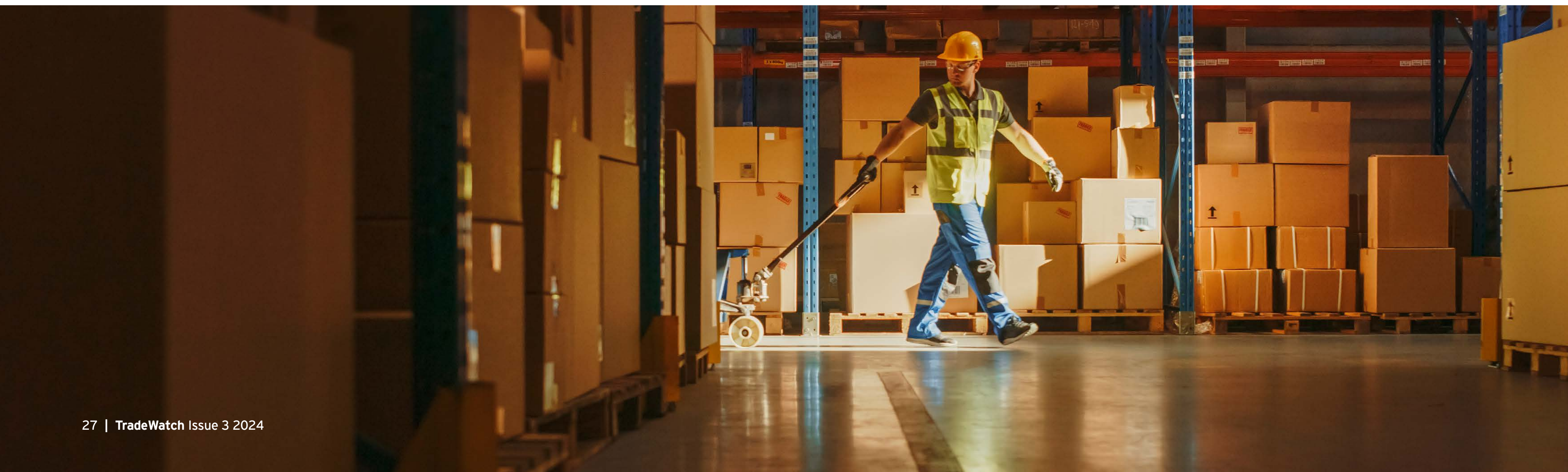
4 STF decide que o imposto incidente sobre licenciamento de software personalizado é o ISS, e não o ICMS – *Supremo Tribunal Federal*. Accessed on 3 October 2024. **Find it here.**

- **The time of supply:** The reform bill brings an innovation to the taxation of services and intangible goods regarding the time of the taxable event, which allows for the charge to be made (the tax point). Currently, the tax point is at the time of payment. With the reform, the tax point could be on completion of the service or at the time of payment, whichever comes first. This innovation will require the taxpayer to distinguish between the date of payment and the date when the imported service is completed. Certainly, if this wording is maintained, it could lead to the creation of a new obligation for the taxpayer, who will have to exercise strict control of the dates. In the recent past, the now-defunct Siscoserv[5] system performed this function, although it did not have a revenue-raising purpose.
- **Use and enjoyment:** Exports, services and tangible goods will be exempt from the new taxes, as long as the operation is provided to a person who is resident or domiciled abroad and whose consumption occurs abroad. Consumption is defined by the bill as the use, exploitation, enjoyment, fruition, or access to these services. However, taxpayers may still not be clear as to how the new taxes should apply to these transactions, especially regarding whether services will be perceived as being used in Brazil or abroad. This confusion is precisely the main reason why the provision that guarantees the immunity of ISS on service exports is so little used in Brazil's current system.

Import and export of tangible goods

For imports of tangible goods, the bill defines important aspects, such as the import tax rate being the same as that applied to domestic operations and the tax base being the customs value plus import tax, IS (if applicable), Siscomex Fee, AFRMM (additional charge for the renewal of the merchant marine), CIDE (Contribution on Intervention in the Economic Domain), anti-dumping duties, countervailing duties, safeguards, and other customs fees incurred until the goods are released. In other words, the calculation bases for imports and domestic operations will be the same.

5 Siscoserv was a computerized system related to services and intangibles as well as business strategies for foreign trade in services and intangibles approved by Legislative Decree nº 30, of 15 December 1994, and promulgated by Decree in 1.355, of 30 December 1994.



PLP also defines that the tax rate to be used is that of the place of import. The IBS taxation (ICMS/ISS) will be defined by the States and Municipalities of Brazil, reinforcing that there will continue to be autonomy for States and Municipalities to define their own tax rates.

Regarding the place of import of tangible goods

Art. 68. For the purposes of IBS and CBS taxes on the imports of tangible goods, the place of import of tangible goods corresponds to:

I. *the place of delivery of the goods to the final recipient, as per Art. 11 of this Complementary Law, including in international shipments*

II. *the main domicile of the purchaser of warehoused merchandise or*

III. *the place where the loss was characterized*

Shipment for specific export purposes

Shipments for specific export purposes are operations that precede exports and are treated as "indirect exports." This happens when a manufacturer or person interested in marketing their products abroad sells their stock to an intermediary in Brazil, who acquires the goods locally and takes care of the export.

Shipments for specific export purposes are guaranteed the suspension of taxes on the local operation, extending the effects of the immunity given to exports and thus stimulating foreign trade in Brazil.

The tax reform includes indirect exports, widely used by the agribusiness sector, among others. However, it brings important innovations in relation to the current format of this relief:

- The requirement for the specific qualification of the commercial export company (the acquirer of the goods to be exported and who is in charge of effectively exporting it).
- The requirement that the commercial exporter be certified in the Brazilian Authorized Economic Operator (AEO) Program.
- The requirement that the commercial exporter has a net worth equal to or greater than BRL1 million and once times the total value of the suspended taxes.
- The reduction of the deadline to export the goods: from 180 days, after the acquisition of the goods in Brazil, to 90 days.

Let's consider these aspects in more detail:

- **Commercial export company:** The specific qualification as a commercial export company is not new, as this certification already exists, regulated by SECEX Ordinance No. 23/2011[6] and brought into the legal system by Decree-Law No. 1,248/1972.[7] However, the requirement that the shipment operation be carried out only by companies qualified as commercial exporters is new.

6 Ministério do Desenvolvimento, Indústria e Comércio Exterior. Secretaria de Comércio Exterior. SECEX Ordinante No. 23/2011. Available at: Portaria SECEX n 23 de 14 07 2011 – Alterada pela 159_160_161 de 2021 e 163 de 2022. Accessed on 5 September 2024. Find it here.

7 Presidência da República. Decree-Law No. 1,248. Accessed on 5 September 2024. Find it here.

This requirement may place an additional restriction on the use of operations that suspend taxes on the first sale of indirect exports.

- **AEO authorization:** The need for certification in Brazil's AEO Program aims to ensure that companies have adequate security and compliance procedures, aligned with the best market practices and requirements of Brazilian customs. Commercial operators that carry out these activities should pay particular attention to the need to be certified with AEO status for shipments for specific export purposes.
- **Net worth requirement:** The required net worth value of BRL1 million is relatively aligned with the requirements of companies that operate as qualified commercial exporters, as this registration already carries minimum net worth requirements and seems to be in line with the requirement of the first item mentioned above.

By limiting the net worth qualification to once times the value of the suspended taxes, the legislation does not clarify how this comparison should be made. This is because the volume of operations carried out by the sectors that use this type of operation is significant, as in the case of the agribusiness sector. Thus, there are doubts about how this measure should be handled: should it be a comparison with the value suspended in each operation individually or in relation to the sum of all suspended taxes? Depending on the values involved, it is possible that using the shipment for specific export purposes provision may prove to be unfeasible in practice.

- **Export deadline:** Finally, the reduction of the deadline to export is a significant restriction. If the deadline is not met, the suspended taxes must be collected immediately, without prejudice to the penalties applicable for the delay in collection. However, there is a provision for the extension of the deadline, depending on the characteristics of the products. Once again, the legislation is vague regarding the definition of which characteristics would be criteria for the authorization of the extension.

The new legislation maintains the regime of allowing shipment for specific export purposes, as it is a mechanism that stimulates and enables Brazilian exports, boosting the country's trade balance and attracting investment and so it seems positive for businesses. However, in maintaining this regime, the reform proposes potentially significant new restrictions, which must be debated in the next stages of the implementation of the tax reform.

Special customs regimes

Another important aspect of the tax reform is the maintenance of most of the special customs regimes. There was much speculation about this issue and about how it would impact Brazilian foreign trade if the special regimes were abolished, since, initially, the tax reform was widely advertised as broadening the tax base and putting an end to fiscal incentives. However, the likelihood that most of the current special customs regimes will be retained in the reform seems to be a positive move for businesses.

Special customs regimes are used worldwide, and many of them are based on treaties and international agreements to which Brazil is a signatory, which cannot be ignored by constitutional force. Thus, many businesses were very apprehensive about the possible abolition of these regimes; but Constitutional Amendment No. 132/2023 ensures that a complementary law should address the application of special customs regimes.

The bill presents (in Title II) several chapters on special customs regimes and export processing zones. The new legislation categorizes special customs regimes, differentiating between deposit regimes, temporary stay regimes, improvement regimes applicable to the oil and gas sector (REPETRO), and those concerning capital goods. The bill briefly addresses these regimes, delegating the operational details and their definitions to specific legislation.

Although the law does not contain a definition of improvement regimes, the term is understood to mean the regimes aimed at encouraging operations that promote some industrial activity in imported or exported goods, or both simultaneously. This would apply, for example to duty drawback and the Special Customs Regime for Industrial Warehouse under Computerized Control (RECOF).

Some sub modalities of the duty drawback regime, (such as intermediary, vessel, international bidding, without currency coverage, or drawback for services) were not mentioned in the bill. However, specific legislation should address the maintenance, modification, or revocation of these sub modalities.

On the other hand, RECOF, which had not been expressly mentioned in the original text of the bill, was included in the amendment that was approved by the Chamber of Deputies, responding to requests by Brazilian traders that were troubled by the lack of explicit mention of RECOF, since there were mentions of drawback.

REPETRO, in turn, was mentioned in a specific section but the bill lacks detail. However, the project does cite all the sub modalities of REPETRO (such as temporary, LNG-temporary, industrialization, permanent, national, and warehouse), at least recognizing their existence.

As for the regimes concerning capital goods, the only ones mentioned in the reform are REPORTO and REIDI, covering investments in port areas and infrastructure projects. However, investments made by predominantly exporting companies, which currently benefit from RECAP, seem likely to lose their incentives, as this regime has not been secured for IBS and CBS.

By choosing to be brief, the legislation proposes, by omission, not to revolutionize the current system of special customs regimes. From this perspective, the signal for traders is positive, as it sends a message to the market that the regimes will be adapted to the new taxes, ensuring that continue to operate as they do today.

Another advantage is that many regimes, which were federal, when applied to state taxes needed a piece of legislation called an "ICMS Agreement" issued by the Council of Fiscal Policy (CONFAZ). Under the reform, special customs regimes should cover both federal and state taxes, providing more equity and fewer distortions.

Thus, RECOF, for example, should act as an improvement regime for both CBS and IBS (state tax). This change could make this regime attractive to more companies in the future. Currently, RECOF is often overlooked in companies' feasibility projects because it does not suspend the state tax portion of the indirect taxes due, unlike drawback (at least in relation to imports).

The same comment applies to the Special Incentives Regime for Infrastructure Development (REIDI) and to REPORTO, which currently only affect federal taxes (REIDI, in this case, suspends only PIS/COFINS, leaving IPI, in the case of goods, and ISS, in the case of services, outside the scope of the regime). In the intended future scenario, there will be an extension of the application of these incentives.

Timing

Although the Senate intends to approve the reform bill within the second half of 2024, there is already speculation that this approval will be postponed to the following year. This is because there are still municipal, Senate and Chamber of Deputies elections in 2024, and, in addition, the reform bill may need to compete for time on the Congress's agenda with the approval of the Budget Law for 2025. We will continue to report on these developments and their implications for business in the coming months. ■

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Back to Welcome

Canada: Surtaxes on Chinese-origin EVs and steel and aluminum products

Effective 1 October 2024, the government of Canada (the government) implemented a 100% surtax on all Chinese-made electric vehicles (EVs). In addition, as of 22 October 2024, a 25% surtax applies on Chinese-origin imports of steel and aluminum products. The government is also considering the application of surtaxes on a range of critical goods and minerals as well as additional trade-related measures to address Canada's overall economic security interests.

Background

On 24 June 2024, the Department of Finance Canada announced a 30-day consultation, from 2 July 2024 to 1 August 2024, on potential policy responses, including the potential imposition of surtaxes on imports of Chinese EVs, to protect Canada's auto workers and its growing EV industry from what it states are China's alleged unfair trade policies and practices and to prevent potential trade diversion of Chinese EVs in response to recent action taken by Canada's trading partners.[1]

The Canadian government is concerned that the growth of Canada's EV industry is at risk of being undermined by the recent increase in imports of Chinese EVs in Canada and other markets. The government contends that the increase in exports of Chinese EVs is due to unfair support through China's use of non-market policies and practices that artificially reduce production costs and lead to significant overcapacity in Chinese EV production. The government believes that China's continued

1 "Consultations on potential policy responses to unfair Chinese trade practices in electric vehicles," Government of Canada website, 2 August 2024. Find it here.

use of non-market policies and practices for EV production may adversely affect planned EV investment in Canada and the transformation of the Canadian automotive sector.[2]

Surtax on EVs

The 100% surtax on all Chinese-made EVs applies to electric and certain hybrid passenger automobiles, trucks, buses and delivery vans. The surtax will apply in addition to the 6.1% most-favored nation import tariff that is already levied on Chinese-origin EVs.[3]

Surtaxes on steel and aluminum

Effective 22 October 2024, a 25% surtax is levied on steel and aluminum products from China.[4] The final list of steel and aluminum goods subject to surtax is available on the Department of Finance Canada website.[5]

For the purposes of the surtaxes on steel and aluminum products, goods originating from China will be considered goods eligible to be marked as a good of China in accordance with the Determination of Country of Origin for the Purpose of Marking Goods (Non-CUSMA Countries) Regulations.[6]

The surtax applies to:

- Both commercial and personal importations, including goods shipped to Canada from a country other than China.
- Goods released from a customs bonded warehouse or sufferance warehouse on or after 22 October 2024, regardless of the date of importation.
- Goods eligible for classification in the tariff items of chapter 99 of the Schedule to Canada's Customs Tariff – except for goods that are temporarily imported for repair in Canada or re-imported into Canada after being exported for repair – even though they are entitled to the Most-Favoured-Nation zero customs duty rate under that chapter.

The surtax will not apply to:

- Goods eligible for classification in the tariff items of chapter 98 of the Schedule to the Customs Tariff, other than the prohibited importation tariff items of 9897.00.00, 9898.00.00 and 9899.00.00.
- Chinese goods that are in transit to Canada on the day that these surtaxes come into force.

The Duties Relief and Duty Drawback Programs will be available to importers for surtax paid or owed by Canadian businesses, subject to the provisions of the Canada-United States-Mexico Agreement (CUSMA).

The government intends to review these measures within one year from their entry into force, and they may be extended and supplemented by additional measures.

Remission of surtax

Canadian businesses may seek a refund or relief from the payment of surtaxes applicable to Chinese steel and aluminum.[7] Remissions may be applied retroactively to the effective date of the surtaxes.

Remission requests are limited to the following instances:

- Situations where goods used as inputs, or substitutes for those goods, cannot be sourced either domestically or reasonably from non-Chinese sources.
- Where there are contractual requirements, existing prior to 26 August 2024, requiring Canadian businesses to purchase Chinese inputs in their products or projects for a specified period of time.
- Other exceptional circumstances, on a case-by-case basis, that could have significant adverse impacts on the Canadian economy.
- Priority will be given to remission requests submitted to the Department of Finance Canada before 8 November 2024.[8]

2 Ibid.

3 For a full list of the subject goods, see "Surtax on Chinese-made Electric Vehicles," *Government of Canada website*. Find it here.

4 For a full list of the initial subject goods, see "Surtax on imports of steel and aluminum products from China," *Government of Canada website*. Find it here.

5 "Final list of steel and aluminum products from China that will be subject to a 25 per cent surtax," *Government of Canada website*. Find it here.

6 "Notice of intent to impose surtaxes on Chinese steel and aluminum in response to unfair Chinese trade practices," *Government of Canada website*, 2 October 2024. Find it here.

7 "Process for requesting remission of surtaxes that apply on certain goods from China," *Government of Canada website*. Find it here.

8 "Canada announces tariff remission process for Canadian businesses importing certain Chinese goods," *Government of Canada website*. Find it here.

Potential further measures and policy changes

The government is also considering the potential application of a surtax on batteries and battery parts, solar products, semiconductors, and critical mineral products that originate in China.[9] It is not clear what rate of surtax would apply or the timing of such a measure; at the time of writing, the government has only indicated that a surtax on the abovementioned items would build upon the surtaxes already announced.

Also, it is noteworthy that the government is exploring whether to adopt potential measures with respect to advancing and defending Canada's economic security interests. Such measures would be separate from current measures applied with respect to Chinese-origin imports of EVs, metals, and critical components and minerals. According to a government notice, the following measures are being considered:[10]

- **Suspension of benefits (non-surtax):** Explore options such as suspending non-tariff-related benefits under a free trade agreement in response to trade actions that harm Canada.
- **Trade remedies:** Consider enhanced trade remedies authorities (e.g., anti-circumvention and enforcement) that could further protect against unfairly dumped or subsidized imports that harm Canadian industry.
- **Investigative powers:** Consider whether new forms of administrative or quasi-judicial investigations or reviews may be needed to achieve economic resilience objectives.
- **Strengthening supply chains:** Exploring potential policy measures (e.g., restricting eligibility to incentives or other trade and investment benefits) to strengthen Canada's supply chains in relation to certain products, for instance in critical or strategic sectors, to limit the sourcing of these products from entities that pose risks related to Canada's essential security interests.
- **Expanding Canadian incentives and tax credits:** Consider expanding incentives for targeted sectors to improve competitive standing (e.g., Canadian critical minerals projects).

9 "Consultations on potential surtaxes in response to unfair Chinese trade practices in critical manufacturing sectors," *Government of Canada website*, 10 September 2024. Find it here.

10 "Background information: Public consultations on potential new measures to advance and defend Canada's economic security interests," *Government of Canada website*, 9 August 2024. Find it here.

- **Trade controls:** Ensure the export controls regime under the Export and Import Permits Act (R.S.C., 1985, c. E-19)[11] continues to address risks to national security posed by exports of advanced dual-use technologies. Consider additional critical or strategic items to be added to the Export Control List or Import Control List as well as where enhanced monitoring may be required.
- **Export duties:** Consider amended or additional authorities to impose export duties or restrictions on specified products in critical or strategic sectors in response to the trade actions of other countries or for Canada's economic security (e.g., through amendments to the Special Economic Measures Act or the Export Act) or through the creation of new, targeted legislation to cover specific sectors, such as critical minerals. Consider specific criteria related to when export duties may be required or products to focus on to protect Canada's economic security.
- **Investing in critical minerals supply chain resilience:** Consider financing options or measures to address price volatility and to support diversification of critical minerals supply chains, including through financing from federal Crown Corporations (e.g., Export Development Canada and the Business Development Bank of Canada), or through other mechanisms to support targeted Canadian direct investment domestically and abroad in strategic projects. Consider public-private strategic holdings of specific critical minerals and/or associated materials to bolster Canada's economic and national security and prevent material shortages.

The proposed measures related to economic security appear to build upon Canada's recent commitments to multilateral and bilateral agreements and initiatives launched since 2023 that deal with economic security and supply chain resilience:[12]

- Canada, along with the US, UK, New Zealand, Japan and Australia, endorsed the June 2023 Joint Declaration Against Trade-Related Economic Coercion and Non-Market Policies and Practices.[13]
- Canada is a participant, along with the US, in the Energy Transformation Task Force, which deals with cooperation on critical clean energy opportunities and strengthening of Canada-US supply chains.
- Canada and South Korea signed an agreement in May 2023 for cooperation on critical mineral supply chains, clean energy transition and energy security.

Next steps

Businesses in the automotive, steel, aluminum, metal stamping, export manufacturing, oil and gas, and construction sectors that source Chinese-origin products will be significantly impacted by the surtax measures. Businesses affected by the surtaxes should review their supply chains and determine whether alternative sourcing options exist.

Notwithstanding the surtaxes, businesses should closely monitor government actions in the coming weeks and months, if they are not already doing so. While surtaxes are not a new phenomenon in Canada, their scope and the geopolitical context in which they are being applied suggests that further measures, whether tariff or non-tariff based, are likely to materialize and further disrupt Canadian and international trade networks. Canada's recent trade actions align with steps taken by the US and the European Union targeting imports of Chinese EVs and Chinese critical manufactures and minerals.

In addition, Canadian businesses must consider the impacts of possible retaliatory measures from trade partners. Of recent note, in response to Canada's imposition of surtaxes on Chinese EVs, the Chinese government has initiated an anti-dumping investigation into Canadian canola seed exports.[14] Should Canada extend the scope of surtaxes or apply other trade measures, further retaliatory responses by the Chinese government may follow. ■

11 "Export and Import Permits Act," *Canada Justice Laws Website*, 1 October 2024. Find it here.

12 "Background information: Public consultations on potential new measures to advance and defend Canada's economic security interests," *Government of Canada website*, 9 August 2024. Find it here.

13 "Joint Declaration Against Trade-Related Economic Coercion and Non-Market Policies and Practices," *Government of Canada website*, 9 June 2024. Find it here.

14 "Statement from Minister MacAulay on China's anti-dumping investigation," *Government of Canada website*, 9 September 2024. Find it here.

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Back to Welcome

Mexico: Strategic preparation for enhanced customs audits

In recent years, Mexico's Tax Administration Service (SAT) has significantly increased its focus on modernizing and optimizing customs audit processes, creating a profound shift in how global trade businesses interact with the authorities.

The unveiling of the Master Plan 2024: Taxpayer Services, Collection, and Auditing[1] marked the start of a new era in tax administration, with SAT leveraging digital advancements to improve tax collection, auditing efficiency and compliance.

Central to this shift is the incorporation of artificial intelligence (AI), poised to enhance customs audits' effectiveness in Mexico.

Role of AI in tax administration

The introduction of AI represents a major transformation in SAT's auditing strategies. By implementing machine learning and graph analytics, SAT aims to more accurately detect high-risk taxpayers, unravel complex tax evasion schemes and identify inconsistencies in fiscal documentation. These tools are expected to be particularly effective in combating smuggling and fraudulent activities through shell companies.

For businesses engaged in global trade, SAT's increased technological capabilities have significant implications. With the Mexican Automated Customs System providing SAT with direct access to comprehensive import and export data, companies must ensure meticulous compliance with their tax obligations.

Expanding audit activity: federal, local and state-level scrutiny

Beyond the technological advancements, SAT has also ramped up its audit activity at both federal and local levels. SAT is not only conducting customs audits at the national level but also through its local offices in various states. Additionally, state governments have become more active in conducting their own audits to ensure compliance with tax and customs obligations within their jurisdictions.

This increased scrutiny, both from federal and local entities, means that businesses must be more prepared than ever to demonstrate compliance. Each audit – whether federal, local or state – can delve into various aspects of a company's operations, from customs valuation and tariff classification to compliance with incentive programs like IMMEX[2]

1 "Plan Maestro 2024," *Mexico Tax Administration Service website*. Find it here.

2 For further information on IMMEX, please refer to our article "Mexico: IMMEX Program – the competitive edge for global trade and nearshoring dynamics," *TradeWatch* Issue 1 2024, page 36. Find it here.

and value-added tax (VAT) certification. A lack of preparation could result in significant financial and operational risks.

Surge in customs audits and VAT certification cancellations

In addition to embracing technology, SAT has notably increased the number of customs audits. This heightened scrutiny has led to a substantial rise in the cancellation of VAT certifications for businesses failing to meet compliance obligations. The consequences of losing VAT certification under the IMMEX program are severe. Companies are not only required to pay the 16% VAT on temporary imports, significantly increasing their financial burden, but they are also obligated to settle the outstanding 16% VAT on inventory – including both components and fixed assets – that remain temporarily imported at the time of certification cancellation.

Moreover, the cancellation forces importers to either regularize the inventory by paying the VAT or reconcile the amount of the VAT credit balance registered in the federal government's systems at the time of cancellation. For IMMEX companies, this situation represents a considerable financial risk, as it affects cash flow and operational costs, making strategic audit preparation all the more critical.

Evolution of customs audits in Mexico

To fully understand the importance of these changes, it's essential to reflect on how customs audits have evolved in Mexico. Historically, audits were manual, time-consuming and less frequent. However, over the last decade, SAT has transformed its processes, shifting toward a more proactive, data-driven approach.

This shift is not only due to technological advancements but also a growing global trend in customs administration. By adopting a robust digital infrastructure, SAT can now conduct more frequent audits with enhanced precision, ensuring that global trade businesses adhere to their tax obligations.

Impact on specific industries

The ripple effect of increased audit activity and VAT certification cancellations extends across several industries. Sectors such as manufacturing, automotive, technology and pharmaceuticals – many of which rely heavily on the IMMEX program – are particularly vulnerable. A sudden financial strain from paying the 16% VAT on temporary imports could lead to higher operating costs, reduced competitiveness and delays in production.

Moreover, industries that manage large inventories of components and fixed assets under temporary importation schemes must prepare for the potential cost of regularizing these goods if their VAT certification is revoked.

Tools for strategic audit preparation: leveraging technology

As SAT continues to integrate AI into its audit processes, businesses must adopt a proactive stance by leveraging technology to manage risks. A key element in this process is the use of advanced data analytics to conduct internal reviews and ensure alignment with SAT's audit criteria.

One critical tool available to global trade companies in Mexico is the Data Stage format. Provided monthly by SAT, this data offers businesses a unique opportunity to compare their own operational data with the information in the Mexican Automated Customs System. This allows for early detection of discrepancies and provides a strategic advantage in preparing for audits.

Practical steps for using technology:

- **Implement data analytics platforms:** By using data analytics platforms, businesses can visualize their import and export data, identifying trends and potential areas of risk.
- **Integrate ERP and inventory control systems with Data Stage data:** Ensure that enterprise systems reflect accurate information, avoiding discrepancies between internal operations and SAT's records.
- **Predictive compliance audits:** Use machine learning models to predict which areas of your business are most likely to attract attention during an audit, enabling a targeted approach to risk management.

International comparison

Mexico is not the only country moving toward a technology-driven audit system. Around the world, other countries are adopting similar strategies. The United States and Brazil, for instance, have also begun implementing AI and machine learning to enhance customs audits.

However, Mexico's SAT has distinguished itself by focusing on the use of graph analytics to track complex networks of transactions and tax evasion schemes.

For multinational corporations, this means that operating in Mexico requires a more tailored compliance approach. Unlike other countries where audits might focus more on financial reporting, Mexico's enhanced customs audits emphasize the importance of accurate data in global trade operations.

Legal implications of Mexico's judicial reform on customs compliance

The recent judicial reform approved by the Mexican government introduces significant changes to the legal landscape, which could have implications for businesses involved in global trade and customs compliance.

Key elements of the reform, such as the election of Supreme Court justices and judges, salary caps, and the creation of a Tribunal for Judicial Discipline, may influence how legal disputes, particularly those involving audits and tax obligations, are handled.

Impact on customs compliance:

- **Uncertainty in legal decisions:** Popularly elected judges could bring new dynamics to how customs cases are resolved, potentially making rulings less predictable.
- **Potential delays:** Reducing the number of Supreme Court justices and introducing public plenary sessions may lead to longer case resolution times, particularly for technical matters like customs compliance.
- **Conservative rulings:** Judges may adopt more cautious positions to avoid scrutiny from the new Tribunal for Judicial Discipline, potentially making it more difficult to challenge SAT decisions.

While the full impact of these changes remains uncertain, businesses should prepare for a more challenging legal environment by strengthening compliance processes and seeking expert legal counsel when necessary.

Contingency planning

Given the increasing complexity and frequency of audits, businesses must not only focus on compliance but also establish robust contingency plans. These plans should prepare companies to respond quickly and effectively to any audit request, whether from federal, local or state authorities.

A solid contingency plan would involve:

- **Ensuring immediate access to documentation:** Have all required documents readily available and organized in a manner that meets SAT's standards.
- **Regular compliance audits:** Conduct internal audits frequently to ensure ongoing compliance with customs regulations.
- **Training and preparation for key personnel:** Ensure that staff responsible for customs compliance are well-trained and equipped to manage any audit process.

Future of customs audits: emerging trends and technologies

Looking ahead, the future of customs audits in Mexico is digital. As technologies like blockchain become more integrated into global trade, businesses can expect SAT to continue adopting cutting-edge solutions to ensure compliance. Blockchain, in particular, has the potential to revolutionize the traceability of goods, making it easier for SAT to verify the origins and journey of products throughout the supply chain.

This emerging technology, combined with AI, could lead to fully automated customs audits in the coming years. Businesses will need to adapt by integrating blockchain into their own systems, ensuring that their records are transparent and traceable in real time.

Long-term strategies: turning compliance into opportunity

The strategic preparation for customs audits is not just about avoiding penalties – it's also an opportunity for businesses to optimize their internal processes. By adopting a proactive approach to compliance, companies can streamline operations, reduce inefficiencies and ultimately improve profitability.

A culture of transparency and accountability is essential to achieving long-term success in this new environment. Companies that prioritize compliance will not only be better prepared for audits but will also be able to foster stronger relationships with authorities, customers and stakeholders. ■

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United States: Election outcome – potential impact on global trade

The implications of the United States (US) presidential election on global trade and tariffs are now at the forefront of economic discussions around the world.

The Republican candidate, former President Donald Trump, has secured the electoral votes needed to become the 47th president of the US. Trump will officially take office on 20 January 2025.

The US plays a pivotal role in shaping international trade dynamics, and the outcome of this election is set to have a significant impact on trade policies, global partnerships, tariff structures and the overall economic landscape, both domestically and abroad.

The election's influence on trade and tariffs

The executive branch of the US government has wide-ranging authority to modify tariff rates and impose trade remedies on the basis of national security or economic injury, including under Section 232 of the Trade Expansion Act of 1962, Section 201 and Section 301 of the Trade Act of 1974, and the International Emergency Economic Powers Act.

Although legislation has previously been introduced to reassert greater congressional authority over trade policy, it is unlikely that Congress will meaningfully roll back presidential powers related to trade and tariffs. As a result, Trump is likely to have sweeping authority to implement significant trade and tariff policy priorities.

During Trump's first term as president (20 January 2017 to 20 January 2021), his administration's trade policy and use of tariffs marked a significant shift in the US approach to international trade. Trump continued to make tariffs a critical part of his presidential campaign in 2024. During his campaign, Trump stated the desire to impose tariff of at least 10% on all goods imported into the US and plans to target additional tariffs on countries like China and Mexico.[1] Trump also has criticized the multilateral trading system and discussed a potential withdrawal from the World Trade Organization.[2]

Trump's forthcoming presidential term also offers him a chance to reshape the US-Mexico-Canada Agreement (USMCA). The USMCA was signed in 2020 during Trump's first presidential term and is set to expire in 2036, unless extended through a review process beginning in 2026. The USMCA introduces a sunset clause mechanism, mandating a review every six years to decide on an extension. If not extended, annual reviews continue until the expiration date. Trump has expressed a desire to invoke the six-year renegotiation provision.[3] Ongoing disputes are likely to be discussed during the potential review process, including disagreements over automobile rules of origin, Mexico's energy policies and the treatment of genetically modified agricultural products. Moreover, Trump will likely seek to raise concerns about indirect market access for Chinese goods flowing through Mexico and benefitting from the USMCA agreement.[4]

1 "Trump's latest tariff plan aims at multiple countries. What does it mean for the US?" *Associated Press website*, 26 November 2024. Find it here.

2 "Trump administration blocks selection of Ngozi Okonjo-Iweala as WTO leader." *Associated Press website*, 16 February 2024. Find it here.

3 "Trump's latest tariff plan aims at multiple countries. What does it mean for the US?" *Associated Press website*, 26 November 2024. Find it here.

4 Ibid.

Actions for businesses

For companies that import into the US, actions to consider include the following:

- Gain a comprehensive understanding of both financial and physical flows, as well as the import duties spent, to assess the potential duty impact in case new tariffs are implemented.
- Assess current domestic or alternative sourcing, first sale for export, duty drawback and restructuring operations.
- Develop a proactive strategy based on a thorough understanding of customs regulations to navigate the complexities of tariffs and manage their impact effectively.
- Keep up with the latest news and developments in trade policies and stay adaptable to quickly respond to changes in trade regulations and tariff rates.

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Back to Welcome

Australia: Advantages of a unique license-free defense environment

In September 2021, leaders from Australia, the United Kingdom (UK) and the United States (US) announced the creation of the AUKUS trilateral defense and security partnership.[1] Through AUKUS, Australia will acquire conventionally armed nuclear-powered submarines and fast-track the delivery of leading-edge capabilities into the hands of Australian defense forces more efficiently. This partnership is intended to protect shared values while promoting security within the Indo-Pacific region.

The decision to enter AUKUS can be contextualized in a rapidly evolving geopolitical environment that impacts Australia's defenses and security interests. Under AUKUS, the Australian Government has enacted significant changes to its Defence Trade Controls Act 2012, with changes to how controlled technologies, information and services are traded between AUKUS partners coming into effect on 1 September 2024.[2] These reforms have specifically come through the Defence Trade Controls Amendment Act 2024 and the Defence Trade Legislation Amendment Regulations 2024 to strengthen Australia's existing defense export control framework while creating new controls and exemptions.

These are significant reforms and mark a substantial step toward defense industry alignment between the three nations. By creating a license-free environment for certain sensitive technologies, each country is expected to benefit from streamlined trade of controlled goods to maintain and drive a trilateral defense capability edge. They also introduce unique deemed exports provisions that restrict the movement of certain goods to non-approved nationals within Australia.

These changes are designed to emulate the trade controls present in the US and its International Traffic in Arms Regulations (ITAR) and its systems. The UK has also made similar changes that came into effect on 1 September 2024. Comparatively, the impact on the US is minimal and predominantly includes export exemptions for ITAR-controlled items being exported to AUKUS partners.

While these reforms effectively grant Australia and the UK with a privileged status only seen by Canada within the US defense industry, they also bring a period of high-risk change to business impacted by the implications of its significant reforms.

What businesses need to know

While streamlining trade between the three nations, these changes also raise questions for businesses involved in advanced technologies and information that appear on a now expanded controlled goods lists in Australia and the UK.

1 "Joint media statement: Australia to pursue nuclear-powered submarines through new trilateral enhanced security partnership," *Defence Ministers website*, 16 September 2021. Find it here.

2 "Landmark legislation to bolster national security and remove red tape for Australian industry," *Defence Ministers website*, 27 March 2024. Find it here.

With new requirements and criminal charges for mishandling of these goods, certain businesses outside of the defense industry are newly captured by this regime and its dual-use definitions. For example, businesses may now be required to comply with the regime if they are involved in the advanced manufacturing of biotechnology, battery technology, and other technology not generally (or solely) associated with defense.

With a focus on the Australian context, businesses need to be aware of several factors:

License-free environment for AUKUS partners: The amendments create a license-free environment for most military and dual-use goods and technology items exported, re-exported, or transferred between Australia, the UK and the US.

Expanded defense strategic goods list (DSGL): The DSGL has been updated to include new items that reflect the evolving nature of defense technologies, particular under its dual-use provisions.[3] This means that businesses may be newly captured.

Deemed exports provisions: The new legislation establishes offenses for the deemed export, re-export, and deemed re-export of DSGL goods and technologies without a relevant permit. This means that businesses must now obtain permits for the transfer of controlled goods and technologies where the transfer occurs within Australia and involves foreign nationals working in Australia. This includes specialists working on those goods as well as support staff, who may inadvertently have access to the controlled goods or technology. This may include administrative or cleaning personnel.

New criminal offenses: The legislation introduces three new criminal offenses related to the supply of DSGL technology to non-exempt foreign persons within Australia, the supply of previously exported DSGL goods and technology, and the provision of DSGL services to foreign nationals outside of Australia.

Further information on these and other elements of the new regime can be found on the Australian Defence Exports portal.[4]

3 "Defence and Strategic Goods List," *Defence website*. Find it here.

4 "My Australian Defence Exports portal, *Defence website*. Find it here.

Action for businesses to ensure compliance

To avoid noncompliance and the potential of committing serious criminal offenses, businesses should take proactive steps to assess their exposure to this new environment. While Australia has provided a grace period for the implementation of the license-free environment reforms, they are now in effect. Businesses need to be across the detail of these changes and need to be proactive to ensure they are fully compliant. Otherwise, they risk extensive repercussions that could potentially harm their reputation, operations, market share, and access to controlled technology.

Key actions that we have seen business take so far include:

Reviewing the DGSL and assessing exposure: The first step for any business has been to assess whether they will fall under the new regime. This includes a thorough review of their goods against the expanded DGSL, with a particular focus on the dual-use list. Businesses are also auditing the location of controlled technologies (down to the specific room within a facility) and understanding which personnel have access.

Reviewing current controls: Proactive businesses have already reviewed compliance programs to identify gaps with the new requirements. This includes reviewing appropriateness of personnel receiving access, the security of locations holding controlled technologies, and understanding the need to obtain the necessary permits for the transfer of controlled goods and technologies.

Uplifting current controls: Where gaps are identified, business have been implementing strategies to ensure compliance. This may include new training programs, removing certain personnel's access to certain locations, and applying for the necessary permits and/or exemptions for non-approved nationals.

Engaging with legal and trade experts: Businesses are consulting with legal and trade experts to understand the full implications of the reforms and to receive guidance on compliance strategies. This has been particularly important for businesses newly captured by defense controls and who have little experience with its landscape.

Ongoing monitoring: To ensure ongoing compliance, businesses can implement an internal monitoring function or seek external support to oversee access

controls, permit timelines and other aspects of adherence to the regime. Given the rapidly changing trade landscape, businesses are also seeking external monitoring support. This may include subscribing to broad legislative monitoring services provided by third parties and bespoke solutions that monitor requirements for a specific business's goods profile in relevant markets.

Next steps for AUKUS

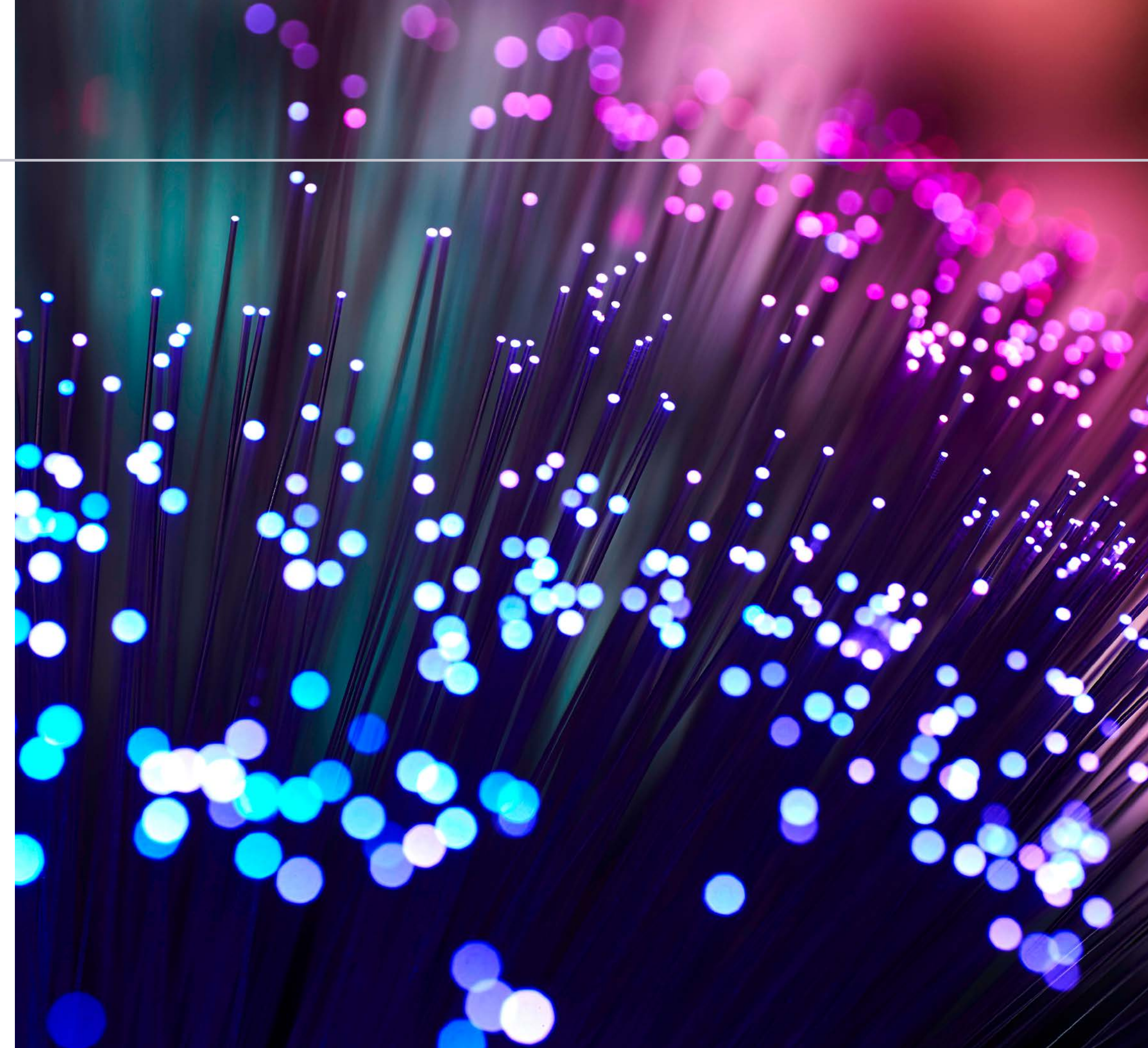
More broadly, the new license-free environment starts to bring to life the defense "free-trade zone" previously promised under previous agreements. This includes the bilateral 2007 Defence Trade Cooperation Treaties and 2017 expansion of the US National Technology and Industrial Base to include Australia and the UK. As a reference point, it also provides valuable insight into how the three countries are moving to align and harmonize under AUKUS.

AUKUS has also shown signs that it may expand to include additional like-minded partners. This includes Japan, which is currently involved on a project-by-project basis. Other additional partners may include Canada, New Zealand and South Korea.

As outlined in our article United States: Election outcome – potential impact on global trade the recent US presidential election results precipitate significant likely shifts in the geopolitical and global trade environment. Given that AUKUS was entered into under the Biden Administration and the significant differences in the Republican trade platform, the re-election of President Trump may impact the progress and specific trajectory of the trilateral security partnership. However, the first Trump Administration supported the US National Technology and Industrial Base in 2017, so the agreement is likely to be sustained.[5]

Given the evolving and dynamic trade environment, it is vital that businesses have the appropriate strategies in place to ensure they are prepared for reforms under AUKUS and other policy initiatives. Doing so can be achieved through internal capability, but more and more businesses are turning to external support as the global regulatory landscape evolves. ■

5 Joint Statement on Australia-U.S. Ministerial Consultations (AUSMIN) 2019, *United States Department of State website*, 5 August 2019. Find it here



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China: Recent customs updates

The 15th exclusion extension list announced of goods subject to tariff imposition by the United States (US)

The Tariff Commission of the State Council decided to extend the exclusion period for Goods Subject to Additional Tariffs on the United States for relevant commodities. The exclusions were due to expire on 31 July 2024. From 1 August 2024 to 28 February 2025, the goods listed in the Appendix will continue to be exempt from the tariffs imposed for the anti-US 301 measures.

Anti-dumping measures extended for imported optical fiber preforms originating in Japan and the US

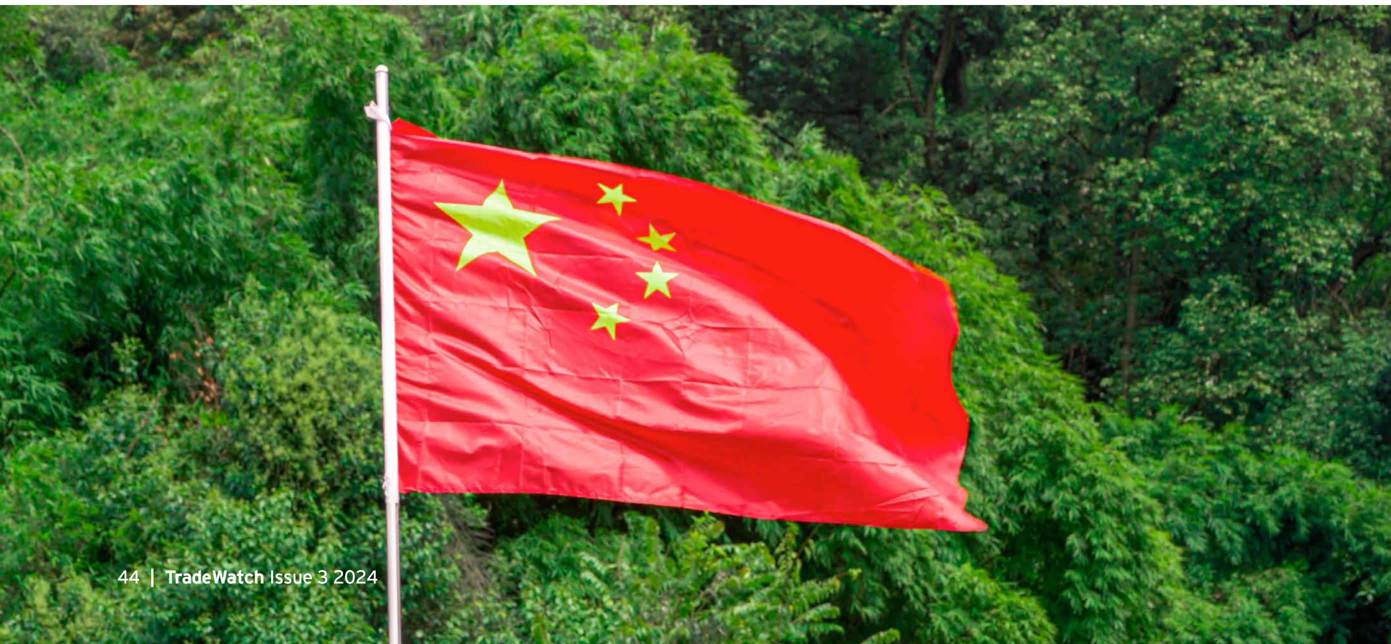
Anti-dumping measures have applied in China since 2015 to imported optical fiber preforms originating in Japan and the US.[1] An optical fiber preform is a quartz glass rod that has a specific refractive index profile and is used for manufacturing optical fibers. Manufactured optical fibers are used for optical signal transmission of various optical cable structures.

The Ministry of Commerce reviewed these measures and has now ruled that if the anti-dumping measures are terminated, the dumping of imported optical fiber preforms may continue or recur, damaging China's optical fiber preform industry.

The Ministry of Commerce therefore made a proposal to the Tariff Commission of the State Council to continue these measures. As a result, the Tariff Commission of the State has decided to continue to impose anti-dumping duties on imported optical fiber preforms originating in Japan and the United States, effective from 11 July 2024 for a period of five years.

The scope of the products subject to the extended anti-dumping duty measures is the same as for the original anti-dumping measures introduced in 2015, i.e., the product is classified in the Import and Export Tariff of the People's Republic of China under 70022010 (except that the diameter of imported products under this tariff number is less than 60mm).

1 Announcement No. 25 of 2015.



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Back to Welcome

Japan: Interim report on the revision of export control regulations

Japan is undergoing a revision of its export control regulations. As a result, export controls are likely to expand to cover a wider range of items than before. This change may mean that exporters who have not previously dealt with the export controls and verification procedures required for sensitive goods and technologies may now be required to do so.

The Interim Report

On 24 April 2024, the Subcommittee on Security Export Control Policy under the Trade Committee (the Subcommittee) of the Industrial Structure Council, established by the Ministry of Economy, Trade and Industry (METI), issued an interim report (the Interim Report), outlining potential revisions to the Cabinet Orders and the Ordinance of the Foreign Exchange and Foreign Trade Act (FEFTA). These revisions were discussed in response to changes in the international security environment. A draft of the revised Cabinet Orders, based on the changes discussed in the Interim Report, will be available for a public consultation period, which will widely invite opinions on the draft before its implementation. While the Subcommittee has not specified a timeline for implementing these revisions, it is expected that most of these changes will enter into force.

Summary of the Interim Report

The Wassenaar Arrangement (WA),[1, 2] established on 12 July 1996, in the post-Cold War era, is a widely accepted framework for export controls today. The WA controls the trade in common sensitive items among its participating countries, rather than targeting specific countries with unique restrictions.

The Interim Report, however, emphasizes that this traditional framework has reached a turning point, necessitating more effective security export controls and the pursuit of new approaches for items that are not currently on the list. It indicates that substantial revisions to Japan's current export control policy are needed, in response to changes in the international security environment, such as those listed below:

- **Emerging risk of military conversion of strategic materials:** National entities that handle strategic materials may acquire dual-use technologies that are not considered to be advanced, but they may further develop them domestically, and subsequently may convert them for military use.
- **Military conversion of general goods:** Among dual-use technologies, there is a high risk of military conversion for general goods and technologies,

1 The Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies is a multilateral export control regime that covers both conventional weapons and sensitive dual-use goods and technologies. *WA-DOC-15-SEC-001-Basic-Documents-2015-January.pdf*. Find it here.

2 The Participating States of the Wassenaar Arrangement are: Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, India, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Republic of Korea, Romania, Russian Federation, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Türkiye, Ukraine, United Kingdom and United States. About us – The Wassenaar Arrangement.

rather than just for those items that are regulated by the current provisions. The fact that even widely available items can be converted for military use exposes the inadequacy of current export controls that depend solely on an item's technological capabilities, instead of including end-use and end-user requirements.

- **Proliferation of sensitive technologies among non-WA countries:** Non-WA countries possess sensitive technologies, which has led to an increase in the spread of these technologies beyond the WA framework. As this proliferation poses a risk of sparking regional conflicts, it is deemed essential to control the non-WA countries' sensitive technologies.
- **Proactive cooperation between exporters and authorities:** A risk of military conversion is no longer confined to specific entities that possess sensitive technologies; it has expanded to affect a wider range of exporters. Exporters must now be aware of potential reputational risks that may arise from their technologies being used for military purposes. To address these challenges, it is imperative for exporters to work closely with the regulatory authorities.

The Interim Report has specifically proposed the following policy revisions to address these issues:

Reinforcement of current complementary export controls

- Strengthen catch-all controls (CA Controls), which is a complementary export control for conventional weapons for general countries except for Group A countries as defined by the United States Export Administration Regulations (US EAR).[3]
- Prevent circumvention via Group A countries.

Development of a dialogue scheme for proactive information sharing between government and private sector

- Implement a mandatory reporting system for technologies and activities with a high risk of technology leakage.
- Establish a public-private dialogue framework to facilitate information sharing.
- Monitor technologies over a long period, even after the transaction, to prevent military conversion.

International cooperation for effective export control

- Flexibly add items to the control list, including those not yet unanimously agreed upon by all WA countries, for regulation among allied nations.
- Proactively cooperate with countries possessing sensitive technologies, that may pose high security risks.
- Coordinate the operational rules for export controls among WA countries.
- Strengthen cooperation with non-WA countries.

Rationalization and simplification of operations

- Allow application of a special bulk license for specific parts used in manufacturing semiconductors, and for machine tools destined for India and Association of Southeast Asian Nations[4] (ASEAN).
- Simplify the procedures for applying for licenses for defense equipment and the goods for civil purposes stipulated under the Appended Table 1-1 of the Export Control Order.[5]
- Conduct on-site inspections focusing on specific topics such as internal export control systems, sensitive technologies in possession, and actual export records.

3 Group A countries are not subject to the current complementary approach to the CA. Find it here.

4 ASEAN jurisdictions are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

5 Export Trade Control Order – English – Japanese Law Translation. Find it here.

Enhance transparency for both domestic and international stakeholders

Among these proposed revisions, strengthening the CA Controls is expected to significantly increase the compliance burden on exporters, since this change would mandate that exporters verify the end-use and end-user requirements for certain items even when exporting to non-restricted countries. Currently, under the FEFTA, an export license is not required when exporting to non-restricted countries (unless specifically directed by the METI). In implementing this change, the regulations will likely be imposed selectively on high-risk transactions, with consideration given to the potential increase in compliance burden for exporters.

- Items subject to CA Controls will be limited to the following:
  - Items with high security risks such as technologies involving precision-guided munitions and military command systems
  - Items for which exporters can verify end-uses and end-users such as products developed jointly with end-users, products manufactured upon request from end-users, and equipment requiring installation and maintenance by exporters in the destination country
- The government will provide information about affected end-users to exporters when they conduct end-user verification.
- The government will provide criteria of how to identify transactions with a high security risk. The guidance provided by the US Bureau of Industry and Security on how to determine "Red Flags"[6] that violate the US EAR will be referred to when creating the criteria.
- Simplification of procedures for obtaining licenses for specific countries, including non-WA countries, will be under consideration.

6 Find it here.

Next steps

The Interim Report highlights that Japan's current non-proliferation export control policy is inadequate and calls for the adoption of new measures to improve its effectiveness. Control lists based on specifications of goods and technologies are no longer adequate to address the expanding risk of military conversion of dual-use technologies. This, therefore, requires a substantial shift toward regulating exports based on end-uses and end-users that pose a security concern for Japan.

With export controls expanding to require verification for a wider range of items, even exporters that have not previously engaged with sensitive goods and technologies may be required to conduct export control verifications. Consequently, companies must establish internal management systems and procedures to comply with new regulations.

Moreover, despite the government's support in sharing information on the affected end-users through the dialogue scheme, companies are still tasked with improving their due diligence on the buyers and end-users of their products. Identifying an affected end-user often involves sifting through a vast amount of company information relevant to its business, which can be challenging to manage. Therefore, it is prudent for companies to consider adopting specialized IT tools or engaging outsourcing services to undertake these tasks.

The Interim Report outlines a policy aimed at fostering cooperation with non-WA countries, with Singapore, Malaysia and the Philippines specifically named. However, it is also conceivable that these countries may strengthen their export control regulations. For companies with bases in the ASEAN region, establishing internal management systems and procedures to comply with the new regulations may present a new challenge.

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Back to Welcome

Korea: Overview of customs law changes for 2025

A number of revision bills for the customs law have been proposed in Korea – some have been passed by the national assembly, while others still need to be deliberated by the national assembly This article provides an overview of customs law changes In South Korea that will come into force from 1 January 2025.

Anti-circumvention dumping measure (AC measure)

Korea has put a legal framework in place for investigating circumvention dumping. The measure was passed by the national assembly and is set out in Article 56.2 of the Korea Customs Act, Articles 71.2 through 71.11 of the Enforcement Decree and Article 20.2-20.4 of Enforcement Rules.

Circumvention dumping refers to a practice, process or work whereby an exporter subject to an anti-dumping duty (AD) or importer liable to pay the duty attempts to avoid that duty. The AC measure has been discussed at a global level but has not been introduced into the World Trade Organization (WTO) rules because agreement was not reached among member countries over what constitutes circumvention dumping. With no global, multilateral provisions under the WTO, members have adopted and implemented individual AC measures in their jurisdictions.

Korea now plans to introduce AC measures. Under the Korea Customs Act, circumvention dumping is defined as the action of *"evading the imposition of anti-dumping duties by means of acts prescribed by the Presidential Decree, such as minor alteration to the physical characteristics or form of the goods subject to anti-dumping duties."* Where this kind of action is identified and confirmed through an investigation undertaken by the Korea Trade Commission, anti-circumvention duties will be imposed on the subject goods. To determine whether there has been a "minor alteration," which points to slight or insignificant modification that does not change the essential characteristics of the goods, due consideration needs to be given to elements such as the physical characteristics, chemical composition, Harmonized System (HS) code, use of the goods, production facilities, and the costs incurred for alteration.

It remains to be seen how the AC measure will work once it is introduced in Korea in 2025. The measure may prove challenging in its operation amid an ever-complicated global value chain, given that the boundary may become more blurred between what is referred to as circumvention dumping and what is referred to as outsourcing and offshoring as strategies for optimal supply chain management.

Other revisions related to Customs Law

- **Increased penalties for misdeclaration or non-declaration of value**
  Where an importer incorrectly declares the value of the imported goods that constitutes willful misconduct under the Korea Customs Act and the Free Trade Agreement (FTA) implementation Act, penalties of 60% of the underpayment will be imposed (up from the current rate of 40%). Where non-declaration constitutes an offense of smuggled importation under the Korea Customs Act, penalties of 60% will be imposed on the amount of customs duties (up from 40% currently). These penalties apply to transactions declared from 1 January 2025.

- **Customs clearance platform dedicated to e-commerce**
  The exponential increase in e-commerce volumes seen in recent years means that streamlined customs clearance is needed more than ever. From 1 January 2026 (after one year of system build-up), e-commerce stakeholders, e.g., vendors and intermediaries (both domestic and overseas) and delivery service providers, who are registered with Customs, will be eligible for expedited clearance for three years. If requested by Customs, they must provide information, such as the purchase date and price, from the time of order or payment for delivery before the time of importation, which will be used for simplified declarations and for the goods selected for inspection.

- **Advance ruling for origin**
  An advance ruling for origin serves as the basis for granting preferential treatment under an FTA. Currently, the application for advance ruling for origin is possible only when an advance ruling is prescribed under the FTA and is available only to a narrow scope of items, such as the price, origin and relief. From 1 January 2025, the limit will be removed so that advance rulings can cover a wider scope of items, to ensure the advance ruling program will work better for importers.

Actions for business

The new provisions and changes to the customs laws for 2025 shed light on a balanced approach being taken by the Korean authorities to the customs goals of trade compliance and trade facilitation. Companies operating in Korea are well-advised to keep track of these changes. Doing so will help traders to enhance compliance and to reduce costs and risks in relation to importing goods into Korea. ■

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Back to Welcome

New Zealand: Customs' compensatory interest regime

New Zealand Customs (Customs) is using compensatory interest (interest) to enforce compliance for importers of goods into New Zealand and increase revenue collection.

Although the regime was introduced in 2018 "to compensate the Crown for loss of use of money when duty is not paid in full and on time,"[1] Customs is increasingly charging importers the full rate of interest at 10.91%. In addition, interest is being charged on import Goods and Services Tax (GST) even in cases where the import GST is recoverable by the importer as input tax from Inland Revenue. Therefore, the imposition of interest may be seen as punitive in nature for many importers and not just a compensatory mechanism.

Importers need to be aware of the potential significant financial impact of interest, particularly in relation to post-importation adjustments, such as royalties and license fees, transfer pricing adjustments, and commissions or rebates.

Background

Compensatory interest replaced the previous additional duty regime. The previous system did not differentiate between compensation to the Crown for the loss of use of money and penalties for noncompliance. Additionally, the prior scheme's use of compounding rates was criticized for creating debts that could become disproportionately high relative to the offense, especially when accumulated over extended periods of time.[2]

Current regime

The current interest regime is a daily charge (but not compounding) in relation to duty not paid in full and on time. It is imposed on importers in relation to the following charges when the amount owed is NZ$1,000 or higher:

- Import duty
- Import GST (GST on imports is defined as a duty)
- Excise duty
- Excise-equivalent duty

1 "Compensatory interest," *New Zealand Customs Service website*, 2 July 2024. Find it here.

2 "Regulatory Impact Statement: Customs and Excise Act Review: Sanctions for incorrect payments – detailed design of a new regime," *New Zealand Treasury website*, 8 February 2017. Find it here.

- Petroleum or Engine Fuel Monitoring Levy
- Synthetic Greenhouse Gas Levy
- Anti-dumping and countervailing duties

The compensatory interest rate is currently set at 10.91%, which aligns with Inland Revenue's interest rate. The rate is determined by the latest Reserve Bank of New Zealand floating first mortgage rate plus 250 basis points.[3] A reduced rate of 5.63% is available where parties voluntarily disclose an error and can demonstrate that it was inadvertent.[4]

In addition to a reduced rate of interest, other differences between Customs and Inland Revenue concern grounds for remission, the lack of application to late payment penalties and restrictions on compensatory interest for overpayments. Customs is only obliged to pay compensatory interest on overpayments if the overpayment can be attributed to an error on the part of Customs.[5]

Purpose of the interest regime

The New Zealand Customs Service Regulatory Impact Statement (RIS) on the introduction of a compensatory interest rate regime states that the core objectives of the scheme are to:[6]

- Maximize core duty collected
- Minimize financial disadvantage to the Crown from underpaid duty
- Minimize administrative costs for government
- Remove unnecessary compliance costs for duty payers through consistency with Inland Revenue in the treatment of revenue owed to the Crown

The RIS also specifically explains that "compensatory interest is not a penalty."

3 Taxation (Use of Money Interest Rates Setting Process) Regulations 1997, s 2.

4 "Compensatory interest," *New Zealand Customs Service website*, 2 July 2024. Find it here.

5 "Compensatory interest and late payment penalties," *New Zealand Customs Service website*, 10 August 2022. Find it here.

6 "Regulatory Impact Statement: Customs and Excise Act Review: Sanctions for incorrect payments – detailed design of a new regime," *New Zealand Treasury website*, 8 February 2017. Find it here.

However, the statement further explains that simply setting the charging rate at the "disadvantaged party's cost of the loss of use of money" would not achieve the objective of maximizing core duty collected. Officials made clear that a rate lower than commercial lending rates available to the duty payer may incentivize deferred payment of duty as a "cheaper alternative to getting a commercial loan, making the Crown an involuntary lender."

With these considerations, officials determined that Inland Revenue's floating first mortgage rate plus 250 basis points was the rate to be applied. The rate is now 10.91%.

Impact of high interest rates and the issue concerning import GST

The current approach by Customs can be viewed as punitive, particularly when compared to Inland Revenue. For example, tax pooling through tax intermediaries in New Zealand was introduced to counter the "punitive aspect of" interest for tax purposes.[7] Tax pooling has the practical effect of lowering an interest bill for a taxpayer for tax purposes. There is no equivalent of tax pooling for interest imposed by Customs. In addition, taxpayers can receive a 50% discount to certain tax shortfall penalties imposed by Inland Revenue for previous good behavior, whereas there is no statutory relief for previous behavior in relation to administrative penalties imposed by Customs.

In addition to the above, Customs imposes interest on import GST regardless of the fact that importers can claim back the GST from Inland Revenue as input tax where the imports relate to the importer's taxable activity.

According to a paper issued by the Office of the Minister of Customs on submissions to the Customs and Excise Bill 2018,[8] Customs collected $8.065 million of import GST, and it was estimated that over 90%[9] of this amount is refunded by Inland Revenue to GST-registered importers.

Therefore, it could appear anomalous that the interest regime for import taxes will allow Customs to impose interest in cases where there is ultimately no revenue at stake for the Crown.

Historically, this has led to industry participants and advisors calling for reform for the administration of import GST between Customs and Inland Revenue.

It was recommended by the Cabinet Economic Growth and Infrastructure Committee that Customs and Inland Revenue be directed to report back to the Cabinet on a streamlined approach that will allow commercial, GST-registered importers to offset their GST liability to Customs against their GST assessment with Inland Revenue. However, to date there have been no significant developments in this area.

Key points for importers

As a result of the potentially significant financial impact of the interest regime, importers should ensure the following:

- Import GST is taken into account concerning the impact of interest imposed by Customs.
- Keep errors to a minimum, particularly for post-importation adjustments.
- Undertake regular compliance reviews.
- Disclose errors promptly to reduce the interest period.
- Identify overpayments of duty to reduce any shortfalls.
- Where qualifying criteria are met, ensure the lower interest rate is applied (e.g., for inadvertent errors).

7 "Impact Summary: Tax pooling to purchase backdated tax," *New Zealand Treasury website*. Find it here.

8 "Departmental Report on the Customs and Excise Bill 2016," *New Zealand Parliament website*, 27 March 2017. Find it here.

9 "Customs and Excise Act Review Paper 5: Increasing efficiency and flexibility in the import and revenue collection system," *New Zealand Customs Service website*, 2015. Find it here.

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EU: Antidumping measures as trade remedies

The General Agreement on Tariffs and Trade (GATT), binding 164 countries, lays out principles and rules of international trade and sets up procedures for dispute settlement. The Agreement also gave birth to the World Trade Organization (WTO), one main objective of which is to achieve smooth and predictable international trade flows. The WTO aims to achieve this by creating a non-discriminatory trading environment whereby one party's exports are treated fairly and consistently in another party's markets. The Most Favored Nation (MFN) rule, perhaps the WTO's most widely known concept, ensures equitable treatment between members. But what happens when certain countries or companies do not play by the rules of free trade?

Antidumping measures

The promotion of free trade and fair competition, core values of the institution, does not preclude the possibility for parties to the WTO to implement certain trade defense measures when they are subject to unfair commercial practices. In recent years, there has been a greater recourse to trade defense measures by many countries invoking not only market distortions but also the protection of critical industries and national security.

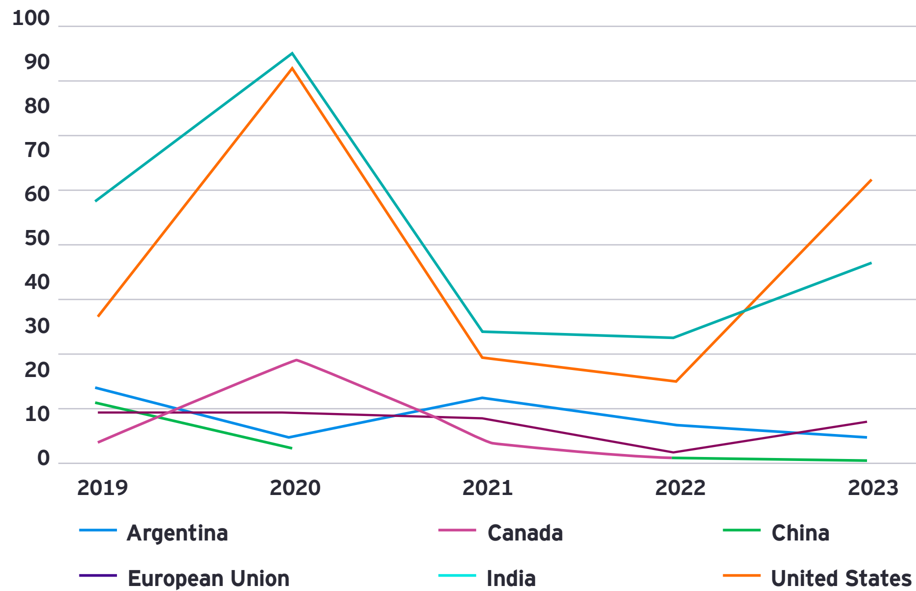
Antidumping measures are an example of instruments of trade defense that can be used, under strict conditions and following a specific procedure, to ensure fair and undistorted competition on global markets. Since 2018, the United States (US), China, and the European Union (EU) have adopted a series of trade restrictive measures targeting the products obtained or manufactured in the territories of each other, engaging in what observers would soon call trade wars, and giving rise to a panoply of international trade barriers: additional duties, safeguards, non-tariff barriers (such as restrictions on a number of technology goods), etc. As a result, the global number of antidumping measures has also increased sharply. This phenomenon of increased trade barriers has sparked worldwide debates on the end of free markets globalization.

India and the US represent a large portion of these investigations, each accounting for 19.3% of the antidumping investigations initiated in the last four years.[1] In contrast, the number of investigations initiated by the European Union (EU) has been relatively constant, and only represented 4% of the total investigations launched over that same period.[2] However, with a default five-year validity and the renewal of most measures, the number of antidumping measures enforced by the EU has also kept growing.

1 "Trade Remedies Data Portal," *World Trade Organization website*. Find it here.

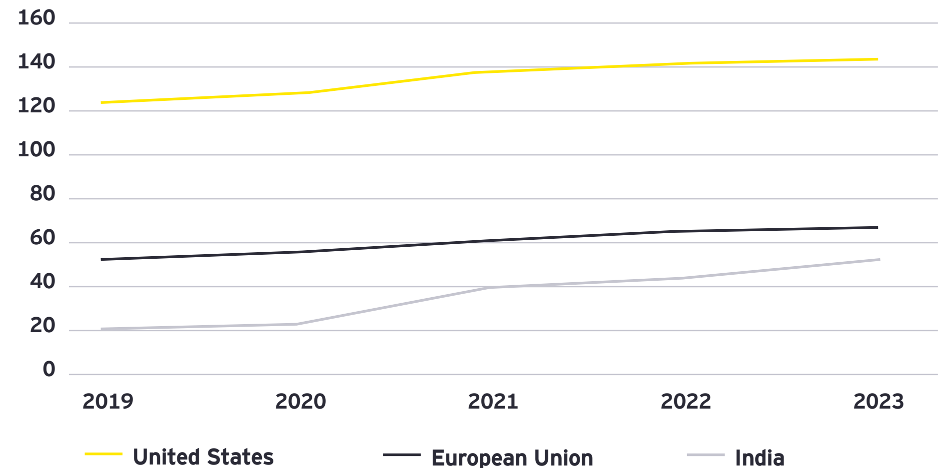
2 Ibid.

ADD investigations per initiation year and importing country



Data source: Home – Trade Remedies Data Portal (wto.org)

Antidumping measures in force against China exports, per importing country



Data source: Home – Trade Remedies Data Portal (wto.org)

As a large manufacturing economy with an export-driven growth strategy backed by the central government, China has been the target of many of the antidumping and anti-subsidies duties adopted by other jurisdictions.

The WTO debate over China's market economy status embodies the international trade tensions. The EU has been cautious about granting this status to China, arguing that the economy is not driven by market forces but by political objectives,[3] and claiming there is an asymmetry in their respective market openings.[4] Earlier this year, the EU Commission updated its report on state-induced distortions in China's economy, thereby reiterating its contention that a specific approach is justified in calculating antidumping duties.[5] The Chinese government contested this approach at the WTO, but later retracted its complaint. In reaction to these developments, and to the recent imposition of countervailing duties on electric vehicles,[6] China recently launched investigations into the dumping of EU brandy, pork, and certain dairy products onto Chinese markets.

3 DG TRADE, SWD(2024)91.

4 "EU trade relations with China," *European Commission website*. Find it here.

5 DG TRADE, SWD(2024)91, "Commission staff working document on significant distortions in the economy of the People's Republic of China for the purposes of trade defence investigations," 10 April 2024.

6 See "Canada: Surtaxes on Chinese-origin EVs and steel and aluminum products" on page 31 in this edition.

The EU's strategic use of antidumping measures

In the EU, the deployment of antidumping measures is governed by Regulation 2016/1036 on protection against dumped imports from countries not members of the European Union,[7] which implements the terms of international agreements reached within the WTO. This regulation sets up a framework for antidumping measures in the EU and establishes procedures for their deployment.

In most cases, it starts with a complaint lodged by European producers who believe that they are exposed to unfair competition resulting from dumped imports from non-EU countries. On the basis of a complaint which includes evidence of injury, the EU may initiate an investigation involving exporting producers, producers in the EU, importers and users. The goal of the investigation is to determine whether there is dumping, and whether this represents a material injury (or threat thereof) to European producers. The potential dumping margin is then calculated and compensated as necessary by the adoption of tariff measures. While conducting the investigation, the Commission may, under certain conditions, subject the import of the investigated products to temporary measures such as their registration into national databases, or to provisional antidumping duties paid in the form of a security deposit. These temporary measures are aimed at offering immediate protection against a material injury to the Union's economy that is identified during the investigation. They also allow duties to be collected retroactively if definitive measures are ultimately implemented. If a causal link can be found between the dumping and the material injury in the EU, and if it is not against the overall economic interests of the EU to do so, the Commission may decide to implement definitive antidumping measures.

Antidumping measures can take different forms. They commonly consist of ad valorem duties calculated on the customs value of the imported products, with individual reduced rates for exporters who have cooperated with the investigation. In some cases, the Commission allows certain cooperating exporters to formally undertake to raise their export prices to be granted an exemption. Finally, in some cases, the Commission determines a minimum import price: a price (upon import) under which duties are due to the amount of the price difference.

Antidumping measures are always applied to specific commodity codes and specific non-preferential origins (also known as economic origin, i.e., the nationality of the product). However, the EU regulation foresees certain cases of antidumping circumvention (e.g., economically unjustified consignment via third countries, or limited assembly in third countries). In these cases, the Commission may extend the measure beyond its initial scope.

For example, in 1993, the EU imposed antidumping duties on bicycles originating in China. In 1997, following an investigation into the circumvention of this measure via the import of unassembled bicycles, the duties were extended to certain parts of bicycles. In 2013, following another circumvention investigation, the measures were extended to bicycles consigned from Indonesia, Malaysia, Sri Lanka and Tunisia, regardless of their origin. In 2015, the duties were further extended to bicycles consigned from Cambodia, Pakistan and the Philippines.

Traditionally, the EU has imposed antidumping duties on raw materials or intermediary products such as steel, ceramics, chemicals and textiles, where there have historically been significant concerns about dumping and subsidization. However, more advanced products have recently become the target of these measures, with the examples of solar panels, electric bicycles and electric vehicles. The EU aims to strike a balance between protecting its interests from distorted competition, being integrated into global value chains that also benefit European companies, and maintaining sustainable access to critical raw materials that are heavily dependent on Chinese suppliers.

Other factors must be taken into account; they include heightened political tensions, national security concerns, decline in the EU's industrial production capacity, and differences in labor standards. Increasingly, the EU has considered environmental, social, and governance (ESG) standards in designing trade policies, including trade defense instruments. This is leading to more cases where lower environmental or labor standards in exporting countries are found to impact dumping margins, resulting in potentially higher antidumping duties, and impacting a wider range of products and exporting countries.

7 Regulation (EU) 2016/1036 of the European Parliament and of the Council of 8 June 2016 on protection against dumped imports from countries not members of the European Union. Find it here.

For example, the circumstances of labor are taken into account in the EU investigation into the dumping of polyethylene terephthalate (PET products) from China, including considerations on workers' freedom of movement and collective bargaining ability.[8]

Strategies for global companies in a shifting trade landscape

What can a global company do in this rapidly evolving global trade landscape to stay on top of antidumping?

- **Monitor trade restrictive measures:** In the face of unstable geopolitics and considering the greater recourse to trade policies in international relations, it is important to have processes in place for monitoring trade restrictive measures in all sourcing and marketing regions. These processes will help to reduce the risk of being surprised by a steep antidumping duty, or by a sudden shortage of important materials or equipment. This step is particularly important in complex value chains involving special customs procedures and tax suspensive regimes, as trade defense mechanisms often restrict their use, either by categorically excluding certain goods from being placed under suspensive customs regimes (e.g., inward processing and placing on the EU market) or by imposing control measures and restrictions (e.g., common storage in a customs warehouse).
- **Stay informed:** As trade disputes lead to the adoption of tariff measures around the world, it is vital to stay informed about potential trade barriers, for example, non-EU countries may also start adopting new measures restricting the export of European products to third countries' territories or subjecting them to high tariffs.
- **Adopt robust procedures:** To efficiently monitor the applicability of newly adopted trade defense measures, companies must have robust procedures for determining the customs classification and the non-preferential origin of the materials and products that they trade in.
- **Understand the different legal frameworks that impact the business:** Multinational companies may need to navigate a host of different trade regulations. For EU companies it is important to remember that the United Kingdom's (UK) exit from the EU (Brexit) also had implications for them. The UK was a significant market within the EU and is still a major trade destination for EU businesses. Post-Brexit, the UK has the autonomy to set its own trade restrictive policies, which may lead to divergences from EU practices. Businesses that used to operate under a single EU trade policy, now need to ensure compliance with both UK and EU trade defense measures. This requires understanding the different legal frameworks and procedures for antidumping investigations.
- **Maintain supply chain resilience and flexibility:** As various types of trade barriers are steadily rising, and developing in ways that are hard to anticipate, it is important to choose critical suppliers and trading partners wisely. There is real value in having flexibility and resilience built into the supply chain.
- **Meet the formal requirements:** If a company's imports qualify for a reduced rate or an exemption of antidumping duties, it is crucial to meet the formal requirements laid out in the legislation, and to maintain appropriate records to obtain those reductions. Failing to do so may, upon inspection, subject the import to the highest anti-dumping duty rate and to high financial penalties. ■

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8 For more information on this topic, please see our article EU: European Parliament approves legislation to ban forced labor products, *TradeWatch* Issue 2 2024, page 47. Find it here

Back to Welcome

EU: Countervailing duties on imports of battery electric vehicles from China

On 4 October 2024, European Member States voted regarding a decision to impose anti-subsidy duties on Chinese-origin battery electric vehicles (BEVs). This marks a decision on definitive duties, establishing them for a five-year tenure.

The European Commission (EC) initiated an anti-subsidy investigation on Chinese-origin BEVs in 2023, which concluded on 4 July 2024 with the decision to impose provisional countervailing duties, a significant development in trade defense measures. This action is a response to the Commission's findings that the Chinese BEV sector is, according to the EC, benefiting from trade-distorting subsidies and posing a potential economic threat to the European BEV industry.

The European Commission's investigation assessed the impact of a variety of Chinese subsidies on European Union (EU) importers, BEV users, and consumers, ensuring a comprehensive understanding of the impact. Recent diplomatic engagements have seen intensified consultations with Chinese officials, with Executive Vice President Valdis Dombrovskis and Chinese Trade Minister Wang Wentao at the forefront of discussions. These ongoing technical-level contacts aim to forge a World Trade Organization (WTO)-compatible resolution that effectively addresses the EU's concerns regarding the injurious subsidization practices identified.

The provisional duties, which target three major Chinese BEV manufacturers, are as follows:

- BYD at 17.4%
- Geely at 19.9%
- SAIC at 37.6%

Other Chinese BEV producers, which cooperated with the investigation but were not part of the sample, face a weighted average duty of 20.8%. Non-cooperating companies are subject to the highest duty of 37.6%. Tesla applied for a specific duty which has been set at 9%. These duties will be applied in addition to the EU's 10% tariff for non-preferential origin BEVs imported into the EU from China.

EC and Chinese officials have signaled willingness to continue bilateral discussions on the imposition of duties and potential diplomatic solutions. A Commission Implementing Regulation including the definitive findings in the investigation was published in the Official Journal on 30 October 2024 and entered into force a day later.

Actions for business

Importers of BEVs are advised to determine whether their import flows into the EU are affected by these final duties. Depending on the impact, they are advised to consider engaging in discussions with the Commission by requesting a company-specific ruling.

Businesses should also assess their customs valuation of products impacted by imports into the EU. In the longer-term location strategy and sourcing decisions will be crucial. ■

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Back to Welcome

EU: Restrictive measures against Russia

As the war in Ukraine continues, the European Union (EU) continues to adopt and enforce restrictive trade measures and sanctions against Russia and Belarus. EU traders must be aware of these measures and comply with them. However, the impact of these measures goes beyond the EU's borders, with new measures aimed at preventing activities that bypass the EU restrictions and undermine the impact of its sanctions.

New measures to prevent circumvention by non-EU subsidiaries

On 24 June 2024, the EU adopted the 14th sanctions package of restrictive measures against Russia, amending Regulation (EU) 833/2014.[1] This package introduces a new Article 8a, which requires that EU companies make their best efforts to ensure that their non-established subsidiaries do not engage in activities that undermine the sanctions outlined in the Regulation (EU) 833/2014. Regulation (EU) 2024/1865 amending Regulation (EC) 765/2006[2] on EU sanctions against Belarus, includes the same measure.

In recent months, the EU's focus has shifted from enforcing prohibitions on EU-based companies to tackling attempts to bypass these prohibitions. This change became evident with the adoption of Article 12g in December 2023, requiring companies outside the EU to contractually agree not to re-export goods to Russia if these same goods were initially imported from the EU.

Both Articles 8a and 12g Regulation (EU) 833/2014 aim to prevent activities that undermine the intended impact of EU sanctions, regardless of whether the company involved falls under the jurisdiction of the EU or not.

1 Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilizing the situation in Ukraine.

2 Council Regulation (EC) No 765/2006 of 18 May 2006 concerning restrictive measures in view of the situation in Belarus and the involvement of Belarus in the Russian aggression against Ukraine.

Discussions among businesses and trade professionals about the extraterritorial application of EU sanctions against Russia began when Article 12g was adopted and the debate has intensified with the introduction of Article 8a.

EU principles of territoriality and nationality

As specified in the Article 13 of Regulation (EU) 833/2014, EU sanctions against Russia apply based on the principles of territoriality (i.e., within the territory of the EU, and in respect of business done in whole or in part in the EU) and of nationality (i.e., to EU nationals, businesses incorporated or constituted under the law of a Member State, and aircrafts and vessels under the jurisdiction of a Member State, regardless of their location).

The same limitations are reflected in other EU sanctions regimes, such as those against Iran (Article 49 of Regulation (EU) 267/2012), Syria (Article 35 of Regulation (EU) 36/2012), Venezuela (Article 20 of Regulation (EU) 2017/2063), and the Democratic Republic of Congo (Article 11 of Regulation (EC) 1183/2005).

Following the principle of nationality, the EU applies certain regulations outside its territory, such as the General Data Protection Regulation (GDPR) when foreign entities process data of EU citizens. Similarly, the restrictive measures against Russia apply to foreign affiliates of EU companies, as they are constituted under the law of an EU Member State.

Extraterritorial application

The EU has repeatedly emphasized its commitment to the principles of territoriality and nationality, including in the frequently asked questions (FAQs) related to the Regulation (EU)833/2014. The EU stated that "the sanctions are never extraterritorial" and that "subsidiaries of EU companies are incorporated under the laws of the host country, thus bound by the host country laws." Based on these elements, Article 8a seems to contradict the EU's stance on the scope of its legal authority.

Moreover, the EU stands against the extraterritorial application of foreign regulations from non-EU countries beyond their own borders. In 1996, it adopted the Blocking Statute ((EC) 2271/96),[3] which aims to protect EU operators from the extraterritorial application of the United States (US) sanctions against Cuba and Iran and to prohibit compliance with those laws. The recitals of the Blocking Statute state that "by their extra-territorial application such laws [...] violate international law," which includes the principles of sovereignty, non-intervention, and territoriality as the primary basis for jurisdiction. The Blocking Statute was a direct response to specific US laws and to the possibility for the US administration to enforce secondary sanctions against non-US parties conducting transactions outside the US, with no connection to the US (i.e., with no US nexus). The Blocking Statute also aims to impede compliance with requirements based on ownership and control. It prohibits companies located in the EU and constituted under the law of an EU Member State, even if they are owned or controlled by a US entity, from complying with US sanctions against Iran (Act 6 (iii) of the Annex).

Therefore, it would seem inconsistent for the EU to take this position against the US while asserting that foreign subsidiaries of EU companies, established under a foreign law, should comply with EU sanctions.

Examining recital (27) of the 14th package, it seems that the EU remains true to its core principle, as the recital affirms that sanctions are enforced "within the jurisdictional boundaries established in Article 13." It adds an important responsibility for EU companies, stating that "At the same time, if Union operators are able to and effectively assert a decisive influence over the conduct of [the foreign entity], they may incur responsibility for actions of that [entity] that undermine the restrictive measures and should use their influence to prevent those actions from occurring."

3 Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

Nevertheless, the wording used by the regulator was deliberate. The term "undermine" is used instead of "violate," underscoring the difference between being subject to EU law and violating it and conducting activities that compromise or diminish the effectiveness of EU law. Moreover, "they" refers to the Union operators, suggesting that these operators could be held accountable for actions taken by their subsidiaries, rather than the subsidiaries themselves being held accountable. In fact, an EU court could not find a non-EU company's actions that go against EU sanctions punishable, as the company is governed by foreign law.

While recitals are not legally binding, this one may provide necessary insight into how to interpret Article 8a and it confirms that Article 8a does not establish EU jurisdiction through ownership and control.

The impact of the new measures

That being said, Article 8a Regulation (EU) 833/2014 introduces significant changes to the EU sanctions regime that may make it more difficult for *bona fide* companies to navigate the complexities of the sanctions regime against Russia.

Article 12 of the same regulation already stated that "It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent prohibitions in this Regulation." The FAQs have also indicated that EU companies cannot use their foreign subsidiaries to circumvent the sanctions, for instance, by delegating decisions to them that are contrary to the EU measures, and that EU nationals working for a foreign subsidiary could be held liable for their actions if their effect were to circumvent the measures.

The adoption of Article 8a seems to confirm that the role of EU companies regarding "what happens next" should shift from passive to active. They must not only refrain from being involved in activities of foreign subsidiaries that undermine the EU sanctions, but they must also take appropriate measures to prevent these activities.

Actions for business

In the absence of any further EU guidance on the interpretation of Article 8a, it is our view that EU companies should take appropriate actions to address this new provision and verify to what extent it might be relevant to their activities. To do so, EU companies should:

- Verify how the definitions of "ownership" and "control"[4] may apply to their structures. Ownership is defined as holding 50% or more of the proprietary rights in a legal entity or having a majority interest. Indicators of control may include the ability to appoint or remove a majority of the board members, the right to use the subsidiary's assets, or the ability to manage the subsidiary's business in a unified manner, with consolidated financial reporting. The EU sometimes refer to ownership and control as "influence."
- Consider that merely being "aware" of a transaction that undermines EU sanctions is sufficient to establish liability. For instance, if an EU parent company knows that its non-EU subsidiary is exporting goods to Russia that fall under the prohibitions outlined in Regulation (EU) 833/2014, and those exports would be deemed prohibited had they been made from within the EU, the parent company could be held liable.
- Conduct a risk assessment based on the country of establishment of their subsidiaries, their business flows, their sector and the type of goods, software or services that they could trade with Russia.
- Implement policies, controls, and procedures to mitigate the risk of undermining the sanctions. They should be able to demonstrate to the authorities that they made every effort possible to prevent their subsidiaries from engaging in activities that would be prohibited if conducted by them.

If this level of control is not feasible, EU parent companies should analyze and justify why it is not, considering elements such as the degree of effective control over non-EU subsidiaries, the size and nature of the subsidiaries, or the application of the legislation of third countries that may impede the exercise of control over the subsidiaries.

Summary

Article 8a Regulation (EU) 833/20 seems to introduce a proactive role for EU companies to ensure compliance with the EU's sanctions against trade with Russia, while seemingly stretching the EU's influence past its territorial borders. EU companies should, therefore, proactively assess and control their subsidiaries' activities to prevent actions that undermine EU sanctions. These are complex matters. Additionally, as these developments may contrast with the EU's traditional stance on extraterritoriality, EU companies should regularly verify the related EU guidance and seek professional advice to navigate these challenges effectively. ■

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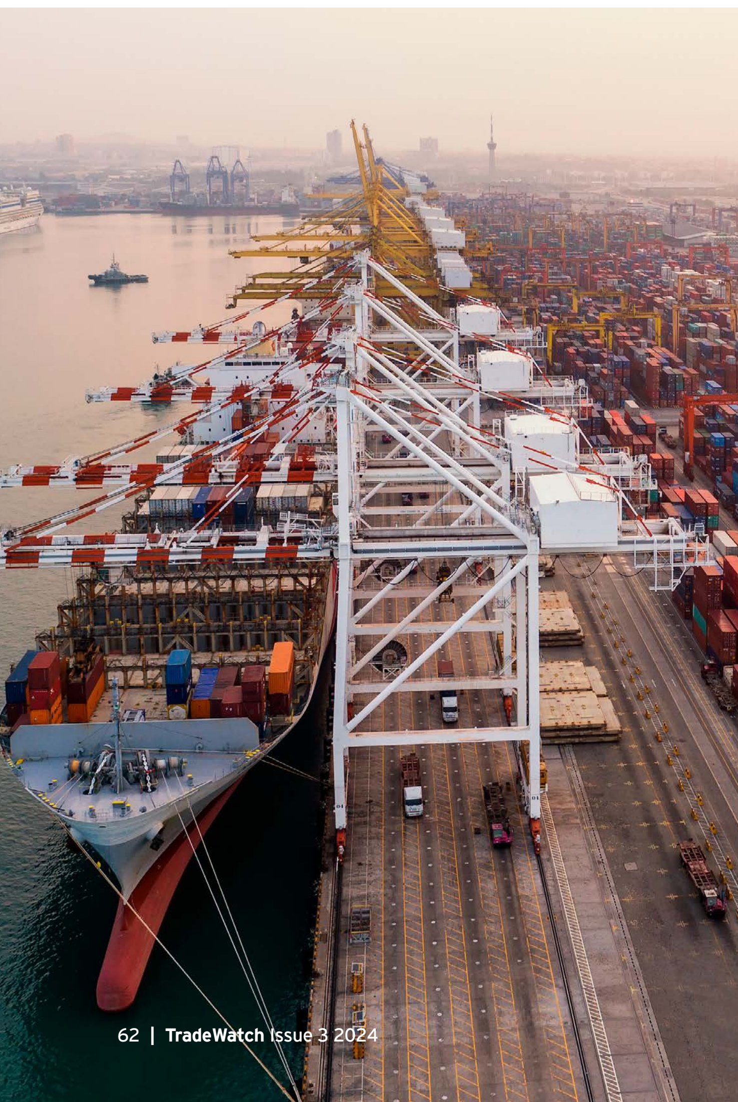
4 Recital (28) in Regulation (EU)833/2014 and "EU Best Practices for the effective implementation of restrictive measures" 11623/24.

Back to Welcome

EU: The sale-for-export principle once more subject for debate



What transaction in a series of sales is to be used to determine the customs value is a topic of significant importance for businesses engaged in international trade and is again subject to debate in the European Union (EU). Several newspapers have reported on an importer scrutinized in Belgium for, in the view of the authorities, using the incorrect transaction in a series of sales to determine the customs value leading to a reassessment.

At the same time the European Court of Justice (ECJ) is poised to deliver pivotal judgments in two pending cases that delve into the nuances of determining the sale for export in a series of successive sales (C-348/24[1] and C-500/24[2]). Also, the Customs Expert Group is discussing two new instruments that relate to this topic.

Facts as presented in the preliminary ruling requests

Facts C-348/24

A Cuban tobacco company engaged in the sale of cigars to a Spanish company, overseeing the transportation of the product from Cuba to a customs warehouse located in Agoncillo (La Rioja, Spain). Upon arrival a distribution firm acted as the consignee and stored the goods under a customs warehousing arrangement.

The cigars, while housed in the Agoncillo warehouse, were destined for various locations. Some were sold by the Spanish company to the distribution company, who then distributed a portion to Ceuta and Melilla – territories outside the EU customs territory – and the remainder to local tobacconists. The cigars sold to tobacconists, which are central to the current legal proceedings, remained under the Spanish companies' ownership until the distribution firm finalized sales agreements with the tobacconists. At that point, ownership transferred to the distribution firm, who then released the cigars for free circulation, enabling their sale and delivery to the tobacconists.

The Taxation Agency initiated several noncompliance records against the distribution firm for the fiscal years 2012 to 2015, citing various reasons. The primary adjustment was due to the declared customs value, which pertained to the sale of Cuban cigars by the Cuban tobacco company to the Spanish company, not meeting the criteria for successive sales. The Taxation Agency contended that the initial sale (from the Cuban tobacco company to the Spanish company) was not explicitly for export to the

1 C-348/24 Find it here.
2 C-500/24 Find it here.

EU customs territory. Consequently, it determined that the customs value should reflect the sale that resulted in the import of the goods into the EU, namely the sale from Spanish company to the distribution company.

Facts C-500/24

In the preliminary ruling request C-500/24, a batch of goods manufactured in Asia was sold through a two-tiered transaction process. Initially, an Asian supplier sold the goods to a Swiss intermediary. This first sale was then followed by a second sale to an international fashion retailer.

Upon manufacturing completion, the goods embarked on a direct journey from Asia to Spain. Upon arrival, a decision was made to release most of the goods into the European market, allowing them to circulate freely. A portion of the goods, however, was earmarked for storage in a customs warehouse, awaiting further distribution.

The goods that entered the free market were destined for a dual-purpose role: some were to be sold within the EU, while others were tagged for export to various third-country destinations. The labels affixed to these goods were deliberately designed to accommodate this flexibility, ensuring compliance with marketing regulations both within the EU and beyond.

In the process of customs declaration, the international fashion retailer decided to value the goods based on the initial transaction price – the price paid by the Swiss entity in the first sale. This approach, however, was met with resistance from the Spanish customs authorities. In a move that challenges traditional valuation practices, the authorities insisted on using the second sale price – the price at which the international fashion retailer acquired the goods – as the basis for assessing customs duties.

Primary issue in both preliminary ruling requests

At the heart of the two preliminary ruling requests is which transaction in a series of sales should be used to determine the customs value, a matter that the ECJ first addressed over three decades ago in the landmark Unifert case (C-11/89)[3].

The applicant contends that the customs value should reflect the sale when goods were placed in the customs warehouse. Conversely, the customs authority argues for the latter sale within the warehouse, challenging the presumption of a sale for export in chain transactions for goods with ambiguous final destinations. It basically questions whether 'sale-for-export' should be interpreted geographically, requiring the export destination to be the EU's physical territory, or commercially, requiring the destination to be the EU market.

Although the cases are dealt with under the predecessor of the Union Customs Code (UCC) – the current legal customs framework in the EU – that allowed the first-sale-for export principle, the ECJ's forthcoming decisions are anticipated to refine the concept of sale for export and provide clarity on handling such transactions under the current UCC, particularly Article 128 UCC-IA, which governs the timing of valuation.

Two new cases under discussion

The Customs Export Group, Valuation Section (CEG VAL) discusses customs valuation matters and also prepares new non-binding instruments to be included in the compendium on customs valuation. Although the instruments are non-binding, they represent a valuable source to interpret EU customs valuation provisions and are typically adhered to by the customs authorities in the EU. Although the following cases are not converted into instruments, they provide valuable insights into the discussions of the CEG VAL on the concept of a sale for export.

1. **Goods sourced from non-EU procurement company**

   The first case revolves around a complex chain of transactions involving multiple sales across international borders. At the core of this chain is a distributor based within the EU, who initiates the process by placing orders with a central purchasing entity situated in a non-EU country. This central purchasing company then forwards the order to the actual manufacturer, who is also located outside the EU. Upon receiving the order, the manufacturer dispatches the goods directly to the distributor firms within the EU.

   When it is time to handle customs formalities, the distribution company acts as an indirect representative and files the customs declaration on behalf of the central purchasing company. In

3 Judgment of the Court (First Chamber) 6 June 1990, Case C-11/89. Find it here.

doing so, the distribution company declares the transaction value as reflected in the sales invoice between the central purchasing company and the manufacturer, thereby setting the stage for customs valuation based on this specific link in the sales chain.

In its preliminary remarks, the Commission underscored the absence of a clear legal mandate necessitating the buyer's presence within the Union for the purposes of identifying a sale for export to the Union's customs territory. Consequently, the location of the buyer within the Union should not be regarded as a critical factor in determining the sale of export. This perspective is applicable even in scenarios involving a sequence of successive sales, provided the criteria for employing the transaction value method are satisfied. The Commission elucidated that the role of the distribution company, serving as the indirect representative of the central purchasing company, is a significant factor to consider. According to Commissions viewpoint, the pertinent transaction for assessment is the sale between the manufacturer and the central purchasing company, during which the distribution company within the EU functioned as the indirect representative.

2. E-commerce sales

This case revolves around a sequence of orders placed through an online platform, followed by the acceptance of these orders. An e-commerce company facilitated orders from consumers within the EU to a manufacturer located in a third country. Subsequently, the goods were produced and shipped directly to the customers in the EU. The central issue was determining which transaction should be considered the relevant one for the purpose of customs valuation.

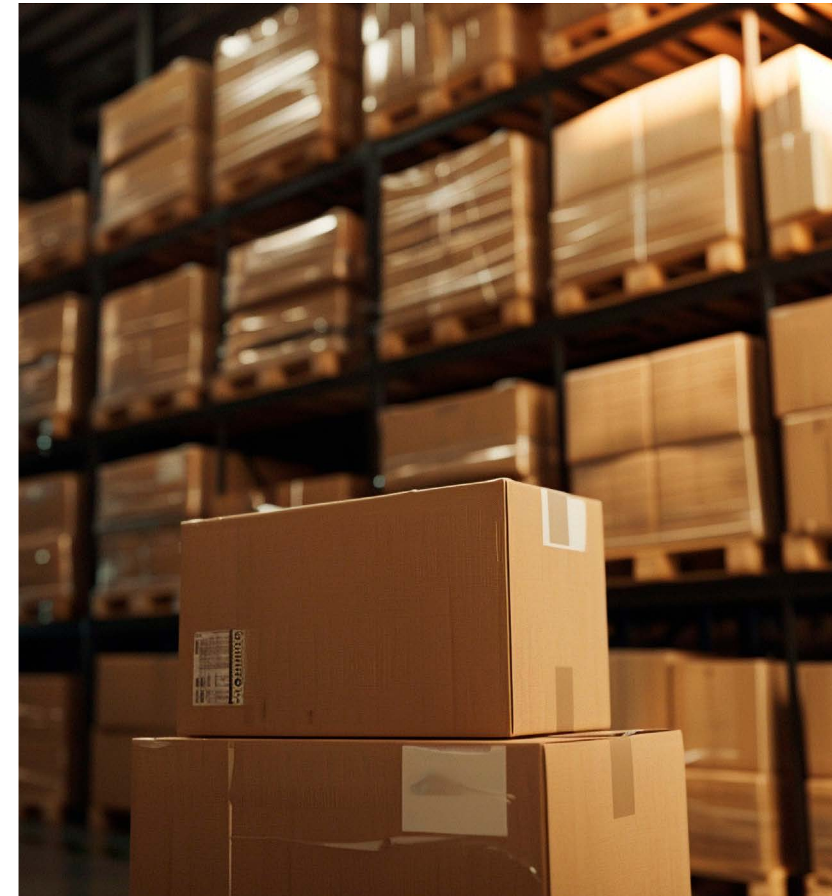
The Commission highlighted that, under the prevailing legal framework, only a single sale can meet the criteria set out in EU customs legislation. In the view of the Commission, for the first scenario, the significant sale for valuation is the business-to-business (B2B) transaction between the manufacturer and the online company.

The second scenario differed in that the online company, prior to finalizing the purchase order from an EU customer, sought confirmation from the manufacturer for the acceptance of the order.

In the context of the second case, the Commission referred to a comment by a Member State regarding the notion of a 'distance sale' as defined and utilized under the VAT Directive. The Commission clarified that such a concept is not recognized in the current customs legislation, although it has been suggested for inclusion in the context of e-commerce transactions for customs valuation purposes in a proposed legal reform of customs procedures.

Actions for business

The apparent scrutiny from the customs authorities based on news reports, the pending ECJ's court rulings and ongoing discussions in the CEG VAL underscores the importance of tracking the developments in this area and reviewing the customs valuation position of companies involved in a series of sales. ■



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Back to Welcome

Türkiye: The impact of changes for cross-border e-commerce

Türkiye has amended its customs law to address quality degradation issues affecting an increasing number of goods sent from abroad via the post and express couriers.[1]

The Decision on Amendments to the Decision on the Implementation of Certain Articles of the Customs Law No. 4458 was published in the Official Gazette No. 32624 dated 6 August 2024. This decision makes changes to the tax rates and value limits of goods to be brought into free circulation in Türkiye by passengers, by post or by express cargo transportation.

In this article, we provide a brief overview of the background and scope of changes for cross-border business-to-consumer (B2C) electronic commerce (e-commerce) in Türkiye and discuss some of the impacts of the change.

Background

Goods arriving to an individual in Türkiye via postal or express courier transport, within specified limits, can be declared through a Simplified Customs Declaration (SCD). This is done by paying a single and fixed duty through the postal administration or express courier operators that meet conditions determined by the Ministry of Trade of Türkiye. Or the goods can be declared under the normal customs procedures, within the designated limits.

According to an announcement made by the Ministry of Trade on 6 August 2024, due to the quality degradation of goods coming into Türkiye from abroad via post and express courier and the rapid increase in these imports, there has been a

1 Turkiye reduces allowed value limits on and increases duties applicable to B2C e-commerce shipments, *EY tax alert*, 7 August 2024. Find it here.

surge in complaints from consumers, manufacturers, merchants, industrialists and chambers of commerce regarding sales, production and employment losses.

For this reason, both the single and fixed duty rate applied to imports was increased and the limit for imports within the scope of the Simplified Customs Declaration was reduced. Although the increase in duty rates was initially on the agenda, there was also a significant reduction of the limit in Simplified Customs Declaration transactions recognized for express courier operators. As the normal import transactions will be applied for shipments above the specified limits, import transactions that no longer qualify for the simplified procedure will likely to be slower and import costs will likely increase.

Limits and taxation

Under the legislative amendment, the value limit is reduced from EUR150 to EUR30 for goods subject to the single and fixed duty that do not have a commercial quantity or nature, that arrive in Türkiye to an individual via postal or express courier transport, and that are declared through Simplified Customs Declaration by the postal administration or express courier companies. Additionally, the single and fixed duty rate levied on these shipments has been increased from 20% to 30% if the shipment comes directly from European Union (EU) Member States, and from 30% to 60% if it comes from other jurisdictions.

For example, previously, a product purchased from outside the EU for an order valued at less than EUR150 would be subject to 30% single and fixed duty. Following the latest amendment, the limit for a product to be purchased from abroad subject to payment of the single and fixed duty is reduced from EUR150 to EUR30, and for products under EUR30 which are shipped directly from outside the EU, a duty at twice the rate of the previously paid duty (60%) will be applied.

Sample calculations

Example 1: Single and fixed duty rate

Before the amendment

Let's assume that a consumer has purchased a handbag online from a company based outside the EU on Monday, 3 June 2024. The sales price of the product is stated as EUR20 on the website. The table below presents the tax amount that the consumer would be required to pay (in this example, TL209.34).

Sale price	Exchange rate – Central Bank of the Republic of Türkiye (31.05.2024)	Sale price in Turkish Lira (TL)	Single and fixed duty rate	Potential challenges facing circular trade
EUR20	34,8910	697.82	30%	209.34

After the amendment

If the same consumer wishes to purchase a bag with a sales price of EUR20 on Sunday, 1 September 2024, through the same platform and the same company which is based outside the EU, the table below presents the tax amount that this consumer would be required to pay (in this example, TL452.88).

Sale price	Exchange rate – Central Bank of the Republic of Türkiye (01.09.2024)	Sale price in Turkish Lira (TL)	Single and fixed duty rate	Potential challenges facing circular trade
EUR20	37,7402	754.80	60%	452.88

As it is shown in the above tables (example 1), after the amendment, duty at twice the rate of the previously paid duty is applied to a product under EUR30 that is shipped directly from outside the EU.

Further, the value limit for goods arriving in Türkiye to an individual via postal or express courier transport and declared under the normal procedure without a Single Customs Declaration by a postal administration or express courier company has been reduced from EUR150 to EUR30. Under Article 126 of Decision No. 2009/15481, goods that do not constitute a commercial quantity or nature and are valued at more than EUR30 but not exceeding EUR1,500 can be declared for free circulation under the normal procedure by the postal administration or express courier company authorized as an indirect representative.

Example 2: Limit changes

	Duties				Non-duty measures	
HS Code	Customs duty (import from third countries)	Additional customs duty (import from third countries)	RUSF[2]	VAT	Communiqué on Surveillance in Import (Communiqué No: 2020/9)	Communiqué on the Import Inspection of Consumer Products (Product Safety and Inspection: 2024/12)
4202.32.90.90.00	3.70%	30%	6%	10% – and 20%	True	True

With the new regulation, the goods above the mentioned limit will now be subject to the normal customs procedures. It is anticipated that these transactions will be negatively affected in terms of both taxation and import process and customs clearance costs. As the duty amount to be paid in a normal procedure will increase and in the case of a product that is subject to a permit or analysis, these procedures must be also carried out. This will therefore prolong customs clearance and increase import costs such as storage.

Impacts on cross-border e-commerce parties

The innovations brought by digital transformation and the increasing trend of e-commerce with the rise in internet usage have created new opportunities in this sector by changing consumer habits. This trend was accelerated by the COVID-19 pandemic when many more consumers started to purchase goods online.

As mentioned in the report called "E-Commerce in Türkiye Outlook Report" published by the Ministry of Trade on 27 May 2024, in Türkiye, the volume of e-commerce reached 1.85 trillion Turkish liras in 2023, an increase of 115.15% compared with the previous year ($77.89 billion). The number of transactions increased by 22.25% compared with the previous year, amounting to 5.87 billion.[3]

In the above-mentioned report, the Ministry of Trade forecasts that in 2024, the e-commerce volume will reach 3.4 trillion Turkish liras and the number of transactions will be 6.67 billion.

Further, in the same report under the title of countries with the most cross-border e-commerce, according to the Ministry of Trade, the jurisdictions most popular with Turkish consumers for cross-border e-commerce are, in order, Canada, the United Kingdom, the United States of America, the Russian Federation, Germany, Azerbaijan, and the Netherlands. This ranking has been established based on the evaluation of cross-border goods e-commerce transactions conducted through the Simplified Customs Declaration, with respect to the export aspect.

2 The Resource Utilization Support Fund Rate (RUSF) is a special fund applied to imports into Türkiye that are made on a credit basis.

3 E-Commerce in Türkiye Outlook Report, *The Ministry of Trade*, 27 May 2024. Find it here.

It is understood from the announcement made by the Ministry of Trade on 6 August 2024 that the new regulation was made to improve sales, production and employment factors in Türkiye. However, the new limits and duty rates announced may deter consumers in Türkiye from placing orders from abroad through online platforms. This situation may also negatively affect express courier operators and online platform owners who may have already made substantial investments in e-commerce. Also, these changes came into force on 21 August 2024, giving companies only 15 days to comply with the new regulations.

Following the regulation in question, a globally operating sportswear company made an announcement in August that it had suspended its online sales operations in Türkiye. The reason behind the suspension is possible delivery problems due to prolonged customs procedures.

The issues caused by this change to express courier operators are significant. The reduction of the limit in Simplified Customs Declaration transactions will switch the transactions (valued at more than EUR30 but not more than EUR150) from the Simplified Customs Declaration procedure to the normal customs import procedure. This flow may cause an increase in workload in terms of customs procedures for express courier operators.

Conclusion

In today's world of commerce, speed and efficiency have become more important than ever for both companies and individuals. In this trading environment, express courier transportation plays a vital role in completing customs procedures quickly and providing prompt access to international shipments. However, the recent regulatory changes in Türkiye are creating economic pressures on consumers and express courier companies, leading to financial difficulties. Increases in tax rates and changes in value limits are affecting the dynamics of international trade by raising costs, which may present significant challenges for both individual consumers and commercial enterprises. ■

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CBAM – a balancing act

The Carbon Border Adjustment Mechanism (CBAM)[1] is a central element of the European Green Deal.[2] By adopting this border adjustment levy for greenhouse gases (mainly, but not only, CO2) imported into the European Union (EU), the trading bloc wants to prevent companies from relocating their emissions-intensive production of goods to countries outside the EU with lower or no carbon pricing (carbon leakage).

However, the EU CBAM can create significant issues for businesses that could prompt them to reconsider and redesign their operations, including where they are located. Businesses face an important balancing act to find the right mix of location, CBAM cost and competitiveness.

Not only is CBAM likely to increase the administrative burden for affected businesses, but the levy could also impact the competitiveness of important EU industries. Therefore, the European Commission has deliberately designed the CBAM as a dynamic legal instrument whose effects are to be reviewed regularly so that the EU can react to any unintended economic consequences it may create.

Companies should, therefore, actively and continuously review the mechanisms used for carbon pricing (including the EU Emissions Trading System (ETS), EU ETS II, CBAM and any energy taxes) and their impacts.

Businesses should consider the issues outlined below.

Affected products and emissions

Currently the categories of goods subject to CBAM are cement, fertilizer, iron and steel, aluminum, electricity, and hydrogen. Numerous pre-processed and processed products are also included. This means that many parties in a supply chain are potentially affected by the related compliance obligations.

1 For more articles on this topic in recent editions of *TradeWatch*, visit here.

2 The European Green Deal, *European Commission website*. Find it here.

By 2030, many more products will be covered by CBAM. Initially they will include other metal goods, polymers (plastics), various chemicals and petroleum products. However, the list can be extended, and it may be expected that the portfolio of goods covered by CBAM will increase significantly. If so, the CBAM regime will increase substantially for many companies in terms of the products covered and the amount of imported goods subject to the levy.

Consideration is also being given to expanding the emissions subject to CBAM, such as including greenhouse gases related to the transport of goods (not just their manufacture).

Simulating costs

Cost simulations can help to inform business decisions, including strategic procurement, long-term supply chains, and investments in production sites and technology. This principle applies even on a day-to-day basis. For example, every purchasing department will have to estimate CBAM costs to calculate the actual cost of purchasing goods from third countries or to compare different procurement options.

Data from third countries

The transition phase for CBAM reporting began in October 2023. It provides for a CBAM reporting obligation until the end of 2025. EU customs declarants or indirect agents who release goods for free circulation are required to submit quarterly CBAM reports.

Effective from the CBAM report for the third quarter of 2024, due to be submitted in October 2024, the challenge for importers is third-country producers must provide information on actual embedded emissions data — that is, actual data on the specific embedded emissions of those products as well as details about the production method, carbon cost paid in the origin countries and the specific details of the manufacturing installation.[3] This obligation requires non-EU suppliers to monitor, calculate and share this information.

Since many suppliers are providing the required information for the first time and in accordance with the new EU CBAM standards, data quality issues may arise in practice. Therefore, a comprehensive check of the data obtained is recommended to prevent the use of inaccurate or implausible data.

Fortunately, the European Commission and the national CBAM authorities now also recognize that it is not always possible for importers to obtain the data required. In this respect, importers must prove that they have made every effort to obtain the relevant data (i.e., that they have approached their suppliers in a targeted manner and then followed up several times). In the individual EU Member States, different national regulations apply as to which values are to be entered as placeholders in the CBAM reports or whether the evidence of the unsuccessful supplier approach must be uploaded directly to the report in the appendix.

How the levy is calculated

From 2026, the border adjustment will be activated. Customs declarants or indirect representatives must purchase allowances for emissions generated in the third country, the price of which is based on the European Economic Area (EEA) certificate costs under the EU ETS.

The CBAM is calculated based on the quantity of imported goods, the direct and indirect emissions incurred during production in the third country (electricity, heating and cooling), and the price of the certificate. Any emission costs that can be proven to have been paid in the countries of manufacture may be deducted. The amount of emissions is determined on one of the following:

- The basis of the actual emissions (insofar as these are detected and certified by independent experts)
- Standard values (benchmark values for emissions from the production of certain goods in the respective country or region of origin)
- Fallback values, based on the most emitting EU production facilities

The details of the calculation of the required CBAM certificates and thus the expected costs will be regulated in another legal act, which will probably be issued in 2025.

3 As EU CBAM reporting progresses to actual emissions data, what should companies do next?, *TradeWatch Issue 2 2024*, page 36. Find it here.

Introduction and registration

To avoid overburdening the economy, the border adjustment will slowly increase in the introduction phase until 2034. This is a mirror image of the reduction in the free allocation of emission certificates. From 31 December 2024, customs declarants or indirect representatives will be able to apply for an authorization as an "Authorized CBAM Declarant." It will no longer be possible to import CBAM-affected goods from 2026 onward without this authorization.

Other jurisdictions around the world are also planning to introduce border adjustment measures, such as the United Kingdom (UK) and Norway. Other countries, such as Australia, and the other states in the EEA could follow in the near future. Ultimately, the CBAM concept is likely to be of interest for all countries that have already introduced comparatively high levels of carbon pricing.

Penalties for violations

In the event of violations, companies should deal with the associated legal and corporate risks. In addition to the penalties set out in the CBAM regulation, several EU Member States have set national sanctions that go beyond the EU regulations. From 2026, criminal risks will also apply. Secondary risks must also be considered. These include, for example, the risk of being excluded from public procurement or the risk that unreliability in CBAM processing will also have a negative impact on qualification as a holder of customs licenses and simplifications.

First practical experiences

So, what has been the experience of businesses so far in complying with the new regime?

- **Data:** One of the challenges that businesses are encountering is the procurement of the necessary information for CBAM reporting. It requires data from multiple sources, including suppliers, customs clearance and the business's own enterprise resource planning (ERP) system.
- **Roles and responsibilities:** CBAM reporting requires the involvement of several corporate functions across the company, and these complex process chains require a clear definition of roles and responsibilities. Technical instructions or training in relation to CBAM and appropriate documentation (including a RASCI (responsible, accountable, supportive, consulted, informed) matrix, process documentation and work instructions) are crucial. It is also important to design, implement and document appropriate prevention and control measures.
- **Insourcing and outsourcing:** Depending on the volume of CBAM-relevant imports undertaken by the company, CBAM processing can lead to a considerable administrative burden. Various possibilities exist for the internal organization of CBAM processing in the company, with greater or lesser degrees of centralization of process steps. Another important decision will be deciding which activities are best handled in the company and which are best handled by third-party service providers, for example, to have specialized bodies manage resources or handle activities.

  In our experience, the purchase of a CBAM software solution alone is not enough nor does it always provide the most suitable process support for the company. Therefore, it is important to carry out a comprehensive impact analysis in advance, plan process steps and then consider all organizational variants before adopting a solution.
- **Ongoing review:** Plan for ongoing changes in the law and rules. Companies need keep abreast of the latest developments and constantly review processes or aspects of strategic business planning against the backdrop of carbon pricing to make informed investment and procurement decisions. ■

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Back to Welcome

EU: Deforestation Regulation: an underestimated challenge

With the EU Deforestation Regulation,[1] the trading bloc's battle for global environmental protection enters the next round.[2] From 30 December 2025, large and medium-sized companies must comply with the EU regulation preventing deforestation and forest degradation (the EU Deforestation Regulation or EUDR). Starting in mid-2026, micro- and small enterprises must comply with the regulation. As a result, thousands of economic operators who place certain commodities (and products derived from those commodities) onto the EU market will need to carry out due diligence on their supply chains.

Initially, the EUDR was to apply as of 30 December 2024 (and mid-2025 for micro- and small enterprises). However, on 2 October 2024, the European Commission proposed to extend the implementation of the EUDR by 12 months. Other relevant dates are also adjusted by 12 months. The proposal has been accepted by the Council, and on 14 November 2024, the European Parliament also voted i
n favour. Final agreement on the postponement was reached on 3 December 2024. The new application dates (and potential other changes) will not enter into force until the agreed new text is published in the EU Official Journal. Throughout this article, we have chosen to reflect the new dates.

1 Regulation (EU) 2023/1115 of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010, *European Union website*, 31 May 2023. **Find it here.**

2 Background information on this topic can be found in "EU: Fight against global deforestation," ***TradeWatch*** Issue 2 2023, page 33. **Find it here.**

3 Press release from the Council of the EU, dating 20 November 2024, on the *European Union Website*. **Find it here.**

To comply, companies must demonstrate where the relevant commodities were produced to identify product-related deforestation risks. This task may prove challenging as the composition and origin of goods may vary from batch to batch, and sometimes even within a single batch. This difficulty may apply for bulk goods such as palm oil, charcoal, soy, paper (pulp) and the like, for which the materials have been harvested in different areas or where raw materials from different sources are mixed during transport, storage or the production process. Even with items such as furniture, wood may be used from different countries or plantations. However, the analysis is essential – without conclusive evidence of compliance with the EUDR, certain goods may no longer be marketed in or exported from the EU.

Who is impacted?

Goods scope

The European Commission has identified seven commodities that it says contribute the most to deforestation: wood, cocoa, coffee, soy, palm oil, rubber and cattle. Under the EUDR, these seven commodities, and certain products containing them, can only be imported into, traded within and exported from the EU if a due diligence statement is submitted beforehand. There are no thresholds.

The goods in scope of the EUDR are referred to as "relevant products" and are listed in Annex I to the EUDR by their Combined Nomenclature (CN) code and partly by their product description. Which downstream products are covered by the measure differs per commodity. Only products that are included in the list are impacted. Therefore, having the correct customs classifications in place for each item is crucial. Here are some examples of goods that are and are not affected by the measure:

- Palm oil is in scope, but soap containing palm oil is not.
- Cocoa beans are in scope, and so are cocoa powder, chocolate bars and pralines, but cookies containing cocoa are not.
- In the cattle category, meat is in scope, as well as leather, but milk is not impacted.

Notably, the measure does not just affect classic agriculture and downstream products. For example, in the rubber category, transmission belts, tubes and tires are covered, and the wood category includes (empty) packaging materials.

Operators and traders

Any entity that places relevant products on the EU market for the first time qualifies as an operator. This can be an importer or an EU producer of a relevant product. An entity that exports relevant products from the EU also qualifies as an operator. A trader is an entity that makes products available on the market, that is, purchases products and sells them onward in the EU.

An EU supply chain can have multiple operators. For instance, an importer of cocoa beans is covered, and a manufacturer who processes those cocoa beans into chocolate bars is also covered because it has created a new relevant product. Any subsequent entity purchasing and selling the chocolate bars onward in the EU qualifies as a trader. This means that wholesalers and retailers are also impacted.

Mapping of lands

The EUDR aims to prevent further expansion of agricultural lands at the expense of natural forests. In the future, the regulation could be extended to goods from other habitats, such as peatlands and other wetlands, and savannas. An extension to further products is also possible.

The due diligence starts with determining the geolocation of all plots of land where the commodities of the relevant products were harvested or produced. This must be based on latitude and longitude coordinates using at least six decimal digits. Furthermore, the date or time range of production must be documented. The evidence must be kept for five years. This demands traceability at the batch level – a significant challenge for logistics, storage and data management.

Due diligence statement

Under the EUDR, relevant products may only be brought on the EU market or exported from the EU if all the following conditions are met:

- They are deforestation-free.
- They have been produced in accordance with the relevant legislation of the country of production.
- They are covered by a due diligence statement, submitted to the information system managed by the European Commission.

In the due diligence statement, the operator or trader declares that due diligence has been performed and that there is no or only a negligible risk concerning the first two points.

To perform effective due diligence, a business must conduct a risk assessment. A multitude of traits must be considered, including the presence of forests in the country of production; the presence of indigenous people in the area; whether the area is known for corruption, armed conflicted, human rights violations, or lack of law enforcement; or whether United Nations sanctions have been imposed. Operators must be able to demonstrate how the information gathered was checked against the various risk criteria. If risks cannot be ruled out from the outset, adequate risk mitigation measures must be adopted to achieve a lower risk classification (that is, that there is no or only a negligible risk of noncompliance). These measures may include independent surveys, audits or support for small suppliers to implement the provisions of the EUDR.

Compliance measures

Businesses must implement appropriate policies, controls and procedures to mitigate and manage the risks of noncompliance of relevant products. This includes, in particular, the establishment of an internal control and compliance management system, the appointment of a compliance officer at management level (for large companies), and a review by the internal audit department.

In addition, the EUDR requires annual public reporting (including online) on the due diligence system. Parallels with the reporting obligations under the Corporate Sustainability Reporting Directive (CSRD) and the requirements under the EU Green Claims Directive, which aims to prevent greenwashing, should also be considered.

Companies down the supply chain

As discussed above, the EUDR due diligence obligations do not only apply to companies that place relevant products on the EU market for the first sale (operators) but also to companies further down the supply chain (traders). All companies in the supply chain are impacted. To enable traders to conduct their own due diligence assessments, suppliers must provide them with sufficient information, in addition to the reference numbers of the due diligence statements that have already been submitted in relation to the goods.

The EUDR also applies to farmers, forest owners and traders in the EU, whenever they place relevant products on the EU market or export them.

In the event of violations or missing information in the due diligence assessment, goods may not be imported, placed on the market or exported. In this

respect, the EUDR imposes a new import and export control obligation from a customs perspective. An exemption applies to small and medium-sized enterprises that may rely on due diligence already carried out by their suppliers. Microenterprises may also commission a company down the supply chain to submit the due diligence statement on their behalf.

Risk classification of countries

The EU Commission will carry out a deforestation or forest degradation assessment for all countries worldwide, including EU Member States, and assign a risk classification to them: low, standard or high risk. This risk classification is currently still pending.

For products from low-risk countries, simplified due diligence obligations apply. However, simplified due diligence may only be carried out after having assessed the complexity of the supply chain and the risk of circumvention, that is, the risk that products from low-risk countries are mixed with goods from standard or high-risk countries.

Retroactive effect

The cutoff date for the evaluation of whether land has been subject to deforestation is 31 December 2020. The prohibition to place goods on the market only applies to relevant products produced from commodities that were harvested on land that has been subject to deforestation after that date.

Products that were produced before 29 June 2023 are not in scope of the EUDR.

Special rules apply to timber and timber products falling under the EU Timber Regulation. That regulation shall continue to apply until 31 December 2028. Timber products that were produced before 29 June 2023 and placed on the market from 31 December 2028 shall comply with the EUDR.

To ensure that products can be placed on the EU market, companies should start working now on locating the areas where the products were produced. Doing this is likely to be very challenging for complex supply chains, for goods that are stored for a long time and in the case of bulk materials where batches may be blended before they enter the EU; therefore, additional time may be needed to gather the necessary information.

Due diligence statement reference number for customs declarations

After 30 December 2025, customs declarants must declare in their import and export declarations of relevant products that the goods are deforestation-free and that the relevant due diligence has been carried out. When a due diligence statement is submitted, a reference number is generated. This reference number must be referred to in the customs declaration. Without a reference number, the goods will not be released for import or export.

Where relevant products are imported or exported but the EUDR does not apply (e.g., because of the date of production), specific codes must be included in the customs declaration to reflect this. In these circumstances, a due diligence statement reference number is not required.

Impact analysis

It is crucial that economic operators that will be affected by the EUDR act quickly to identify their responsibilities and to assess the impact on their business. However, the time remaining before implementation is a challenge for most companies. Companies should act as soon as possible to start performing an impact analysis and based on the outcome, plan on further actions.

Like other sustainability-related regulations, the EUDR requires companies to adopt a multidisciplinary approach. Many functions can be involved in this, but the process is likely to include procurement and customs or foreign trade functions as well as sales, master data management, legal and IT departments. ■

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Back to Welcome

EU: Ecodesign and Sustainable Product Regulation

On 18 July 2024, the Ecodesign for Sustainable Products Regulation (ESPR)1 entered into force as part of the EU Circular Economy Action Plan (CEAP)[2] under the European Green Deal (EGD).[3] It is at the heart of the European Commission's goal to decouple economy growth from primary resource consumption, reduce waste and "make sustainable products the norm in the EU."

The ESPR will help address the current linear production process and consumption patterns through "product design, setting new requirements to make products more durable, reliable, reusable, upgradable, repairable, easier to maintain, refurbish, and recycle, and by ensuring energy and resource efficiency and addressing the presence of hazardous chemicals in products."

The ESPR is a package of measures that will impact investment and trade decisions, resulting in business and operating model transformation (with direct and indirect tax consequences). It also will have implications for broader supplier ecosystems. The ESPR replaces the current Ecodesign Directive and will continue to enforce ecological standards for product design; however, the scope is broader, as outlined later in this article.

Under the ESPR, certain products, such as those used for defense, medical devices and food, will be exempt. Priority covered items include:

- Iron and steel
- Aluminum
- Textiles (garments and footwear)
- Furniture (including mattresses)
- Tires
- Detergents
- Paints
- Lubricants
- Chemicals
- Energy-related products (including new and revised existing measures)
- ICT and other electronics products

1 "Ecodesign for Sustainable Products Regulation," *European Commission website*. Find it here.
2 "Circular economy action plan," *European Commission website*. Find it here.
3 "The European Green Deal," *European Commission website*. Find it here.

Starting in 2025, the ESPR will be implemented through delegated acts (essentially product action plans). The acts will be adopted at least 18 months from their entry into force, with longer timelines for small and medium enterprises. This leaves little time for businesses to plan and implement potential changes to product designs, materials composition, setting up repair services for products, etc.

The EU's sustainability initiatives, such as the ESPR and Carbon Border Adjustment Mechanism (CBAM),[4] aim to shift from linear to circular economies, influencing global (and circular) trade. Circular trade includes any international trade transaction in goods, services and intellectual property that contributes to circular economy goals.[5] Circular trade is vital for this transition but faces challenges, such as trade barriers and standardization issues. International cooperation and transparent trade practices are essential for a successful, equitable shift toward circularity.

ESPR overview

The ESPR represents a significant advancement in the EU's environmental policy, aligning with broader EGD goals, and sets a precedent for sustainable product design and consumption on a global scale. Given that product design influences up to 80% of environmental impact over its lifecycle,[6] the ESPR is striking at the core of the issue.

The ESPR aims to enhance circularity, energy efficiency and overall environmental sustainability of a larger range of product groups in the EU market. It will help to protect the environment while promoting sustainable business practices and bolstering the EU's economic competitiveness and resilience. The ESPR also includes the possibility of recovery and recycling critical raw materials, serving to increase security and reduce dependencies for EU strategic sectors — a key priority as outlined in the 2024 Draghi report on the future of European competitiveness.[7]

Essentially, the goal is to reduce the lifecycle environmental impact of products, including reduction of emissions and packaging waste. Under the ESPR, product durability, reliability, reusability, upgradability, repairability and ease of maintenance will need to be carefully considered. Substances known to impede product and material circularity will be restricted.

A sustainable product under the ESPR is envisioned to include:

- Reduced energy consumption and improved energy efficiency
- Increased longevity
- Ease of repair
- Straightforward disassembly for further use
- Ready recyclability
- More recycled content incorporated
- Fewer harmful substances

Other ESPR measures

Digital product passport (DPP)

The ESPR will implement a DPP, effectively a digital ID for products, components and materials, to enhance sustainability, circularity and transparency, while ensuring compliance with regulations. This easily accessible electronic repository will provide detailed information for consumers, manufacturers and authorities to make more informed eco-friendly decisions.

The DPP will facilitate automatic verification of imports by customs authorities. Content for the DPP will include elements such as technical performance, material origins, repair history, recycling options and lifecycle environmental impacts. Greater levels of digitization and sharing of sustainability data will play a critical role in the faster transition of entire value chains to circularity.

4 For more articles on this topic in recent editions of *TradeWatch*, visit here.

5 "The role of international trade in realizing an inclusive circular economy: 05 Enhancing transparency and traceability," *Chatham House*, 4 October 2022. Find it here.

6 "An introduction to circular design," *Ellen MacArthur Foundation website*, 6 June 2022. Find it here.

7 "EU competitiveness: Looking ahead," *European Commission website*. Find it here.

Destruction of unsold consumer products

The ESPR introduces a landmark measure to combat the wasteful practice of destroying unsold products in the EU, specifically textiles and footwear. Large businesses will be required to publicly report the quantity and reasons for discarding unsold goods, detailing how these items are managed according to the waste hierarchy (i.e., reuse, remanufacturing, recycling, energy recovery or disposal).

The ESPR also opens the door to potentially banning the destruction of unsold items across various sectors and will eventually require large and medium-sized companies to disclose detailed disposal information on their websites, promoting transparency and encouraging sustainable practices.

Green Public Procurement (GPP)

The ESPR aims to direct the EU's EUR1.8 trillion public procurement budget toward sustainable purchases by establishing mandatory GPP criteria. This move is expected to substantially increase demand for and investment in sustainable products.

Trade-related concerns

EU sustainability policies, such as the CBAM, EUDR[8] and ESPR, extend beyond EU borders, influencing global suppliers and trade practices. The ESPR, in particular, aims to transform the linear production and consumption patterns into a more circular and sustainable model, impacting a wide range of sectors. A successful transition requires international cooperation and regulatory alignment.

Circular trade flows are at the heart of the transformation required to implement the ESPR. They include international transactions in goods, services and intellectual property that contribute to circular economy goals. Circular business models typically require specific equipment and knowledge, contributing to upskilling, employment and just transition of participating countries.

Potential benefits of circular trade	Potential challenges facing circular trade
▸ Extends useful life of products ▸ Supports employment and new industries (e.g., local repair, waste processing sectors) ▸ Generates and scales up demand for secondary raw materials ▸ Access to affordable quality goods, materials and equipment ▸ Turns waste into a valuable feedstock for domestic and international industry	▸ Non-differentiation between remanufactured goods, second-hand items, waste, etc., can result in trade barriers and/or tariffs ▸ Unpredictable quantity of supply and quality of goods, materials, waste, etc., for circular economy production ▸ Absence of internationally agreed standards ▸ Higher transaction costs and risks for circular economy products

8 See "EU: Deforestation Regulation: an underestimated challenge" on page 72 in this edition.

To address these challenges, enhanced supply chain transparency and traceability are crucial. The ESPR's DPP will help by requiring manufacturers to provide detailed information about a product's history and certification levels, supporting better governance and regulation of circular trade flows while streamlining customs processes.

Ultimately, no single country can achieve an inclusive circular economy on its own. International trade plays a critical role in facilitating the transition, and greater collaboration among the global community is necessary. While some governments have used trade restrictive measures to encourage certain types of circularity activities, a balanced and coordinated international or regional approach is essential to ensure an effective and equitable shift toward circularity globally.

New business models and opportunities

A harmonized EU approach to scaling up sustainable products aims to increase competitiveness, create jobs, green the single market in alignment with the EGD, and offer consumer savings, while bolstering the economy's resilience against global supply chain disruptions.

Businesses stand to gain cost-saving advantages by adapting to resource scarcity and fluctuating raw material prices through innovative business models (e.g., product-as-a-service, sharing platforms, repair services), extended product lifespans and optimized usage. A robust secondary materials market further aids in reducing expenses related to materials, energy and waste management, enhancing business resilience. Selling products as a service, for example, shifts the economic focus from quantity sold to product longevity.

Social economy entities have been at the forefront of circular economy ventures, leading initiatives in recycling, reuse and remanufacturing; digital innovation and adoption thereof in this field will be essential. Collaboration across sectors and supply chain ecosystems will stimulate a faster transition to circularity. It will be important to work together to identify and overcome barriers and share leading practices and advice to fully ingratiate circular business models as the status quo.

Preparatory actions for businesses

The ESPR will bring change to many businesses, with nearly all sectors impacted. Businesses can get ready for the ESPR by:

1. Conducting a product lifecycle assessment (LCA) to understand a product's environmental impact. While specific action plans for product groups are not yet available, businesses dealing with priority products are recommended to understand leading practices in circular economy business models.
2. Evaluating leading-practice circular economy business models and identifying potential obstacles in meeting standards – recovery, recycling, reuse, repair – in product portfolios.
3. Developing a preliminary roadmap required to achieve desired circular business models and products. Steps may involve alterations to product design, material selection and supplier engagement as well as the investments needed for both company operations and the wider supply chain ecosystem.

Businesses are recommended to not see the ESPR in isolation but against a broader sustainability and supply chain regulatory backdrop ■

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Tax alerts

Americas

Argentina

- Argentina eliminates payments on account of Impuesto PAIS for imports of goods
  (04 December 2024)
- Argentina reduces payment term for imports
  (21 October 2024)
- Argentina reduces Impuesto PAIS tax rate
  (03 September 2024)
- Argentina implements withholding-tax exemption for electronic payments
  (27 August 2024)

Brazil

- Brazil moves major VAT reform bill to Senate for consideration
  (05 August 2024)

Canada

- Canada Border Services Agency initiates anti-circumvention investigation into dumping/subsidizing of certain container chassis from China
  (04 December 2024)
- Canadian International Trade Tribunal continues its finding on corrosion-resistant flat-rolled steel sheet products from China
  (04 December 2024)
- United States President-elect discusses tariffs on Canada and Mexico, and additional tariffs on China
  (27 November 2024)
- Canadian International Trade Tribunal issues finding on pea protein imports from People's Republic of China
  (25 November 2024)
- Canada begins to levy surtaxes on Chinese steel and aluminum imports and announces remission order process
  (31 October 2024)
- Canada imposes surtaxes on imports of Chinese EVs, steel and aluminum products, considers surtaxes on critical manufacturing goods
  (19 September 2024)
- Canada Border Services Agency announces transition period and new process for certain customs adjustments
  (22 August 2024)
- Canada Department of Finance releases draft legislation for 2024 budget and other measures
  (21 August 2024)

Colombia

- Colombian 2024 Tax reform bill submitted to Congress, would affect corporate and capital gains rates, among others
  (13 September 2024)
- Colombia prohibits coal exports to Israel
  (26 August 2024)

El Salvador

- Salvadoran Congress approves tax amnesty program
  (09 September 2024)

Global

- Trade Talking Points – latest insights from EY's Trade Strategy team (November 2024)
  (04 December 2024)
- G20 meeting highlights continued support for BEPS 2.0 and international tax cooperation
  (31 October 2024)
- Digital services tax jurisdiction activity summary now available (as at 25 September 2024)
  (02 October 2024)
- Trade Talking Points – latest insights from EY's Trade Strategy team (September 2024)
  (23 September 2024)
- Trade Talking Points – latest insights from EY's Trade Strategy team (August 2024)
  (13 August 2024)
- G20 Finance Ministers affirm commitment to BEPS 2.0 and enhanced global tax cooperation
  (02 August 2024)

Mexico

- United States President-elect discusses tariffs on Canada and Mexico, and additional tariffs on China
  (27 November 2024)

Peru

- Peru enacts 1% Excise Tax on online gaming and online sports betting
  (24 September 2024)
- Peru enacts Special Installment Payment regime for tax debts due by 31 December 2023
  (20 September 2024)

United States

- United States President-elect discusses tariffs on Canada and Mexico, and additional tariffs on China
  (27 November 2024)
- United States election outcome – potential impact on global trade
  (06 November 2024)
- US White House publishes Fact Sheet outlining proposed changes to de minimis shipments exemption
  (19 September 2024)
- USTR publishes final Notice of modification of actions on impacted Chinese origin products subject to increase in additional Section 301 tariffs and applicable exclusions
  (17 September 2024)

Asia-Pacific

China

- United States President-elect discusses tariffs on Canada and Mexico, and additional tariffs on China
  (27 November 2024)
- Canadian International Trade Tribunal issues finding on pea protein imports from People's Republic of China
  (25 November 2024)
- Reform decisions from Third Plenary Session seek to modernize China's tax system
  (07 August 2024)

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- G20 Finance Ministers affirm commitment to BEPS 2.0 and enhanced global tax cooperation
  (02 August 2024)

New Zealand

- Initial Digital Platform Information reporting due in early 2025
  (14 November 2024)

Europe, Middle East, India and Africa

Denmark

- Danish Government plans to introduce a new agriculture CO_2 tax
  (06 August 2024)
- Danish Parliament introduces CO_2 tax on fuels and CO_2-emission tax on industry from 2025
  (06 August 2024)

EU

- European Court of Justice holds relocating production won't enable company to escape additional duties unless relocation is economically justified
  (03 December 2024)
- EU Council adopts trade, import and export ban on products made using forced labor
  (21 November 2024)
- EU details on VAT in the Digital Age (ViDA) package
  (07 November 2024)
- EU CBAM – new consultations on authorizing CBAM Declarants and establishing a CBAM Registry
  (06 November 2024)
- EU has finally reached agreement on VAT in the digital age (ViDA) proposal
  (05 November 2024)
- EU Court of Justice rules on deemed supply for EV charging
  (29 October 2024)
- EU Deforestation Regulation; Insights into 12-month delay and recent updates
  (09 October 2024)

France

- Latest information on electronic invoicing reform
  (17 October 2024)

Germany

- Germany finalizes e-invoicing administrative guidance
  (22 October 2024)

Global

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- G20 Finance Ministers affirm commitment to BEPS 2.0 and enhanced global tax cooperation
  (02 August 2024)

Kenya

- Supreme Court declares the Finance Act 2023 constitutional
  (01 November 2024)
- Kenya Tax Appeals Tribunal rules on excise duty relief for packaging preforms
  (24 September 2024)

Latvia

- Latvia to require business-to-government e-invoicing as of 1 January 2025
  (18 November 2024)

Poland

- Poland releases draft amendments to e-invoicing rules
  (08 November 2024)
- Poland presents framework for National e-Invoicing System
  (05 November 2024)

Saudi Arabia

- Saudi Arabia announces 18th wave of Phase 2 e-invoicing integration
  (03 December 2024)
- Saudi Arabia announces 17th wave of Phase 2 e-invoicing integration
  (04 November 2024)
- Saudi Arabia announces 16th wave of Phase 2 e-invoicing integration
  (30 September 2024)
- Saudi Arabia announces new fee rules on customs services
  (10 September 2024)
- Saudi Arabia announces 15th wave of Phase 2 e-invoicing integration
  (03 September 2024)
- Saudi Arabia announces 14th wave of Phase 2 e-invoicing integration
  (05 August 2024)

Slovakia

- Slovakia introduces tax on sweetened nonalcoholic beverages
  (20 September 2024)

South Africa

- South Africa publishes amendments to customs duties on lead-acid batteries
  (13 August 2024)

Spain

- Spain approves invoicing software specifications for taxpayers not using electronic VAT system
  (19 November 2024)

Turkiye

- Turkiye reduces allowed value limits on and increases duties applicable to B2C e-commerce shipments
  (07 August 2024)

Uganda

- Uganda issues Tax Amendment Acts for 2024
  (18 September 2024)

United Arab Emirates

- UAE formally announces introduction of e-invoicing, launches e-invoicing portal and amends VAT Law provisions
  (06 November 2024)
- Dubai Customs announces implementation of the updated customs declaration
  (17 October 2024)

United Kingdom

- UK to publish e-invoicing consultation in early 2025
  (05 November 2024)
- UK Government responds to consultation on introducing UK CBAM
  (31 October 2024)
- UK Autumn Budget delivers significant tax increases but seeks to plan for the future
  (31 October 2024)
- UK to launch a consultation on e-invoicing
  (23 September 2024)

Additional resources

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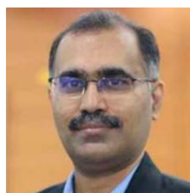

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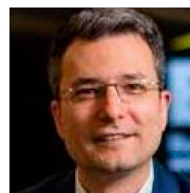

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