

# TradeWatch



## EY Global Trade

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# How can businesses navigate government supply chain resilience initiatives?

Supply chain resilience is frequently cited as the most critical issue facing international trade today. The drivers are many – with the COVID-19 pandemic, geopolitical uncertainty, forced labor, national security and climate change among the largest factors behind this push.

But what policies are governments actually pursuing to help make supply chains more robust? After all, governments don't operate most of the global supply chains crisscrossing the world – companies do.

There is a disconnect between the political rhetoric on increasing supply chain resilience and the practicalities of how companies construct their supply chains, build relationships with suppliers, source alternatives and organize logistics. Further, the myriad announcements, initiatives and agreements make staying on top of the policies that countries are actually pursuing – and what impact they have for businesses – a challenge.

The current state-of-play in the United States (US), European Union (EU), Australia, Japan and the United Kingdom (UK) can reveal what these jurisdictions' actions will mean for companies as they attempt to navigate this challenging period.

## The US and “friend-shoring”

The US' approach to supply chain resilience has perhaps been most explicitly set out by US Treasury Secretary Janet Yellen when she gave a speech to the Atlantic Council in April 2022.<sup>1</sup>

“We need to modernize the multilateral approach we have used to build trade integration,” Yellen said. “Our objective should be to achieve free but secure trade. We cannot allow countries to use their market position in key raw materials, technologies or products to have the power to disrupt our economy or exercise unwanted geopolitical leverage. Let's build on and deepen economic integration – and the efficiencies it brings – on terms that work better for American workers. And let's do it with the countries we know we can count on. Favoring the friend-shoring of supply chains to a large number of trusted countries, so we can continue to securely extend market access, will lower the risks to our economy, as well as to our trusted trade partners.”

This new term “friend-shoring” has caught on, and it encapsulates the fundamental shift in current US trade policy away from strictly free trade and market access negotiations through free trade agreements toward a more interventionist trade policy.

<sup>1</sup> “Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy,” *US Department of the Treasury website*, 13 April 2022. [Find it here](#)



Treasury Secretary Yellen's speech builds on work the US Supply Chain Task Force has been doing. The task force was established by the Biden administration in 2021 and has focused on pandemic-related supplies, advanced batteries, semiconductors, pharmaceuticals and active pharmaceutical ingredients, and critical materials and permanent magnets.

In its one-year assessment,<sup>2</sup> according to the US Trade Representative, the task force has delivered results in six areas, including:

1. Addressing food insecurity in the wake of the war in Ukraine
2. Tackling forced labor in global supply chains
3. Continued collaboration with partners on developing solutions to tackle supply chain issues
4. Facilitating trade in safe and effective medicines and reducing drug shortages
5. Securing smoother and more efficient movement of essential goods during a pandemic
6. Protecting the uninterrupted flow of trade in North America during an emergency

Legislation has complemented this work. The CHIPS Act seeks to promote investments in the US semiconductor sector. The invocation of the emergency provisions of the 1930 Tariff Act lowers tariffs on solar panels from four countries (excluding China). Invoking the Defense Production Act will accelerate production of clean energy technologies,

including solar panels, and provide preferential treatment for domestic suppliers of clean energy in the federal procurement process.

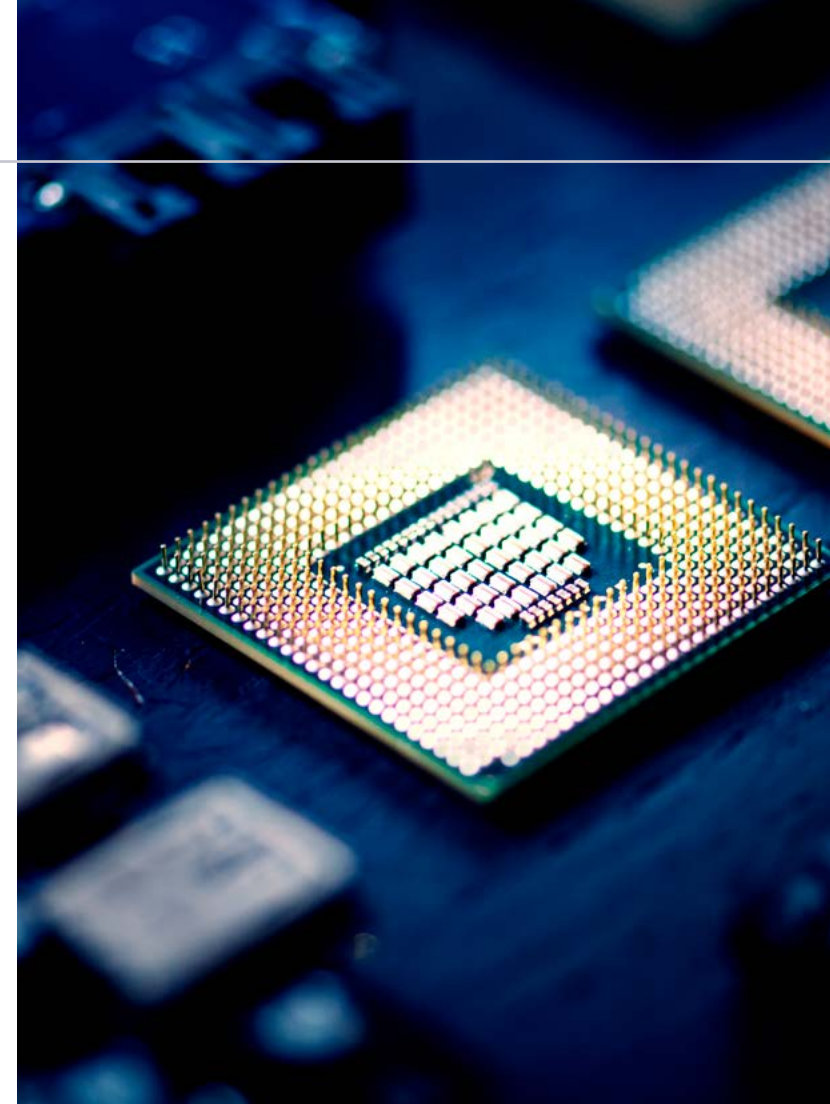
The task force still awaits concrete results – so far, the report deals mostly with “dialogues launched,” “statements negotiated” and the “engaging” of allies and trade partners. Nevertheless, its work signifies the wide-ranging and diverse agenda of government efforts to support and build supply chain resiliency.

This work continues with the recently launched US-led Indo-Pacific Economic Framework for Prosperity,<sup>3</sup> which, through its Resilient Economy workstream, aims to establish “first-of-their-kind supply chain commitments” that would create an early warning system and map critical mineral supply chains to improve traceability in key sectors. This would include coordinating on diversification efforts.

### The question of critical materials

Australia is in the process of establishing itself as a hub of supply chain resiliency initiatives with separate agreements and projects being launched with Japan and India, the US, and the UK.<sup>4</sup> These agreements are in addition to its 2022 Critical Minerals Strategy.<sup>5</sup>

The reason for these resiliency initiatives is simple: shortages of the raw materials, critical minerals and rare-earth components that are necessary for our high-tech economy can create significant supply chain bottlenecks. Semiconductors, for example, require a large array of organic and non-



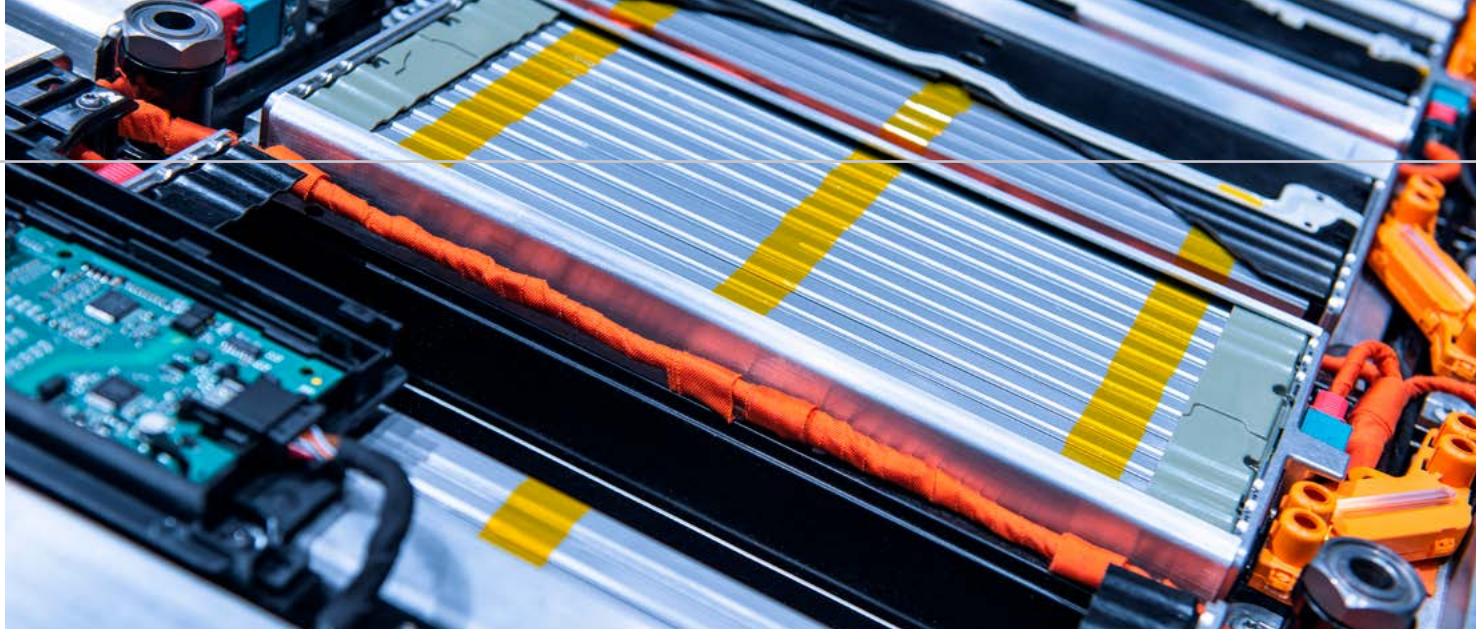
- 2 “Fact Sheet: One Year In, the Office of the U.S. Trade Representative Marks the Anniversary of the Supply Chain Task Force with Key Accomplishments and Continued Efforts to Strengthen Supply Chain Resiliency,” *Office of the United States Trade Representative website*, June 2022. [Find it here](#)
- 3 “FACT SHEET: In Asia, President Biden and a Dozen Indo-Pacific Partners Launch the Indo-Pacific Economic Framework for Prosperity,” *White House website*, 23 May 2022. [Find it here](#)
- 4 “Boosting supply chain resilience,” *Australian Government Department of Foreign Affairs and Trade website*, [Find it here](#), “Joint Statement – Inaugural Australia-U.S. Strategic Commercial Dialogue (AUSSCD),” *US Department of Commerce website*, [Find it here](#), “UK-Australia supply chain resilience capability building initiative,” *UK Government website*, [Find it here](#)
- 5 “2022 Critical Minerals Strategy,” *Australian Government Department of Industry, Science and Resources website*, March 2022. [Find it here](#)



organic compounds and materials, including silicon, germanium and gallium, to name a few. Rare-earth metals – including neodymium, lanthanum, cerium, praseodymium, gadolinium, yttrium, terbium and europium – have a wide variety of uses in renewable energy technologies and high-tech components, such as display screens. The next generation of batteries will require significant amounts of lithium and graphite.

In 2021, the Biden administration signed Executive Order 14017,<sup>6</sup> which ordered a review of vulnerabilities in critical mineral and material supply chains. This led to the US' first supply chain assessment,<sup>7</sup> which found that the US' "overreliance on foreign sources and adversarial nations for critical minerals and materials posed national and economic security threats."

Sourcing critical inputs can be complicated and expensive, and their processing is often environmentally damaging. To address these supply-side constraints, large-scale investments are needed. Currently, much of the world's rare-earth metals are processed in China.



In addition to Australia, Canada is also starting to devote significant resources into its critical minerals capacity, with announcements in its most recent 2022 budget for research, extraction, processing and recycling of such materials.<sup>8</sup> The US announced major public and private investments at the beginning of 2022.<sup>9</sup>

Future developments in recycling and re-use of critical minerals contained in technology devices and other products are a major consideration, as currently many of the individual components prove difficult to recycle into their individual elements to be able to be used in future manufacturing processes.

### European strategic autonomy

The EU's framework on establishing a policy of strategic autonomy is taking shape in the trade policy arena, with the EU creating a policy toolbox to give it the ability to act in areas where it had not previously.<sup>10</sup> The three main areas where this can be seen are through the creation of the following instruments:

- ▶ Anti-coercion instrument (ACI): The aim of the ACI is to deter countries from restricting or threatening to restrict trade or investment to bring about a change of policy in the EU in areas such as climate change, taxation or food safety.<sup>11</sup> This instrument is billed as a measure of last resort. The ACI has not yet been agreed by the various EU institutions.
- ▶ International procurement instrument (IPI): The IPI aims to allow the EU to initiate investigations in cases of alleged restrictions for EU companies in third-country procurement markets, engaging in consultations with the country concerned on the opening of its procurement market.<sup>12</sup> If the consultations prove unsuccessful, the EU will be able to restrict access to the EU procurement market for companies from that country. The European Parliament has adopted the measure.
- ▶ Foreign subsidy instrument (FSI): The FSI would give the European Commission the power to investigate and counteract market-distorting foreign subsidies granted to companies set to

6 "Executive Order on America's Supply Chains," *White House website*, 24 February 2021. [Find it here](#)

7 "Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth," *White House website*, June 2021. [Find it here](#)

8 "\$3.8B Commitment in 2022 Budget Significantly Enhances Canadian Mining Industry's Ability to Provide the Minerals and Metals Required to Reach Net-Zero," *The Mining Association of Canada website*, 7 April 2022. [Find it here](#)

9 "FACT SHEET: Securing a Made in America Supply Chain for Critical Minerals," *White House website*, 22 February 2022. [Find it here](#)

10 See our article "EU Trade Policy: from policymaking to effective enforcement" in *TradeWatch* Issue 1 2022. [Find it here](#)

11 "EU strengthens protection against economic coercion," *European Commission website*, 8 December 2021. [Find it here](#)

12 "EU acts to improve reciprocal access to international procurement," *European Commission website*, 14 March 2022. [Find it here](#)



acquire EU businesses or take part in EU public procurement.<sup>13</sup> The FSI is currently in the process of being adopted by the European Parliament.

Together, these three instruments represent a fundamental shift in EU trade policy aiming to correct the purported distortions in the EU's internal market from unfair or coercive trading practices of the EU's trading partners. Given their relatively recent creation and varying levels of entry into force, how these new instruments will be applied in practice and possible responses from trading partners impacted by the EU's measures remain to be seen.

The EU has coupled these new measures with an overall framework as part of the establishment of the EU's Recovery and Resiliency Facility (RRF).<sup>14</sup> The RRF was directed to undertake "reforms and investments ... [to] help make the Union more resilient and less dependent by diversifying key supply chains and thereby strengthening the strategic autonomy of the Union alongside an open economy." This included investments in digital technologies and infrastructure.

### Trade and Technology Council and semiconductors

The US and EU have been cooperating through the EU-US Trade and Technology Council. At its meeting in May 2022, both the EU and US agreed that "close cooperation to advance the resilience of supply chains is more important than ever."<sup>15</sup>

The EU and US have agreed to develop a common early warning and monitoring mechanism on semiconductor value chains and to undertake information exchange to avoid a subsidy race.

The latter point is particularly important, as both the EU and US have passed their respective CHIPS legislation, which promises large-scale public investments in the semiconductor sector. For the EU, this includes both a softening of state aid rules for semiconductor subsidies provided by EU Member States as well as a mechanism to encourage companies to favor supplying Europe in the case of shortages or other disruptions.

The main reason for focusing on semiconductors as a material concern for governments has been the sector's experience during the COVID-19 pandemic, which saw large-scale disruptions and shortages, bringing entire industries that rely on semiconductors to a halt. Another reason links to more geopolitical concerns. Taiwan is a major exporter of advanced semiconductors, and overreliance on its output increases potential vulnerabilities from an undiversified supplier base. There is also as international competition over control of the most advanced technologies and the next generation of semiconductors. Investments and government policies across Asia, including China Mainland, Taiwan, South Korea and Japan, have been extremely active over the past two years and garnered significant attention.

The US-UK trade dialogue includes a US-UK tech partnership where both sides agreed to work on the resilience and security of critical supply chains. In the UK government's new digital strategy,<sup>16</sup> semiconductor supply chains are identified as a critical issue, although full details of what that will entail are promised as part of a future UK semiconductor strategy.

### National security: screening investments and export controls

The invocation of national security concerns has been on the rise since the Trump administration in March 2018 invoked Section 232 of the Trade Expansion Act of 1962, which allows for tariffs to be raised on products, in this case steel and aluminum, whose imports threaten national security.

The interactions between trade policy and national security have been rising, given the current geopolitical situation. One trend companies need to be aware of is the increased use of both investment screening and export controls by Western governments.

In the UK, this regime is the National Security and Investment Act<sup>17</sup>; for the EU, it is the framework for investment screening<sup>18</sup>; in the US, it is the Committee on Foreign Investment in the United States (CFIUS)<sup>19</sup>; and in Australia, the Foreign Investment Review Board.<sup>20</sup> Historically, these regimes have typically looked at inward investments originating in China. More recently, the EU has issued guidance regarding the impact of Russian and Belarussian investments.

13 "Foreign subsidies," *European Commission website*, 30 June 2022. [Find it here](#)

14 "REGULATION (EU) 2021/241 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 February 2021 establishing the Recovery and Resilience Facility," *Official Journal of the European Union*, 18 February 2021. [Find it here](#)

15 "EU-US Trade and Technology Council: strengthening our renewed partnership in turbulent times," *European Commission website*, 16 May 2022. [Find it here](#)

16 "UK Digital Strategy," *UK government website*, 6 July 2022. [Find it here](#)

17 "New and improved National Security and Investment Act set to be up and running," *UK government website*, 20 July 2021. [Find it here](#)

18 "Investment screening," *European Commission website*, 5 April 2022. [Find it here](#)

19 "The Committee on Foreign Investment in the United States (CFIUS)," *U.S. Department of the Treasury website*. [Find it here](#)





Recent debates in the US Congress have included whether to implement a new regime that would examine outward investment made by US companies in sensitive sectors to China.

This would mirror the increasing complexity of the export control and sanctions regimes around the world, particularly in Western countries. There have been two drivers of this: the war in Ukraine and a desire from the US, in particular, to limit the outflow of advanced and emerging technologies, especially in the case of cybersecurity and military end-use products.

Efforts by the US and EU through the Trade and Technology Council to enhance cooperation has led to a certain alignment of the coverage and use of such controls. This has been mirrored through the Quadrilateral Security Dialogue with the US,

Japan, India and Australia, and the AUKUS trilateral security pact between the US, UK and Australia. This environment of increased complexity for companies navigating export controls can be expected to continue.

### **First Japan, then Japan-Australia-India trilateral**

In 2020, Japan initiated two programs: the Program for Promoting Investment in Japan to Strengthen Supply Chains and the Program to Strengthen Overseas Supply Chains.<sup>21</sup> These measures have been supplemented by efforts to encourage foreign direct investment into Japan in the advanced semiconductor manufacturing sector.

The programs focus on promoting investments in Japanese supply chains included funding for companies working with crucial products, such as semiconductors, electric vehicle battery parts and offshore wind turbine parts. Further funding related to COVID-19- essential products, which included vaccination needles and syringes, disposable gloves, and pharmaceutical cold chain logistics-related supplies. In 2021, the program launched 151 different projects.

Japan's program relating to overseas supply chains initially focused on Japan's supply chains with Association of Southeast Asian Nations (ASEAN) countries. However, its second round of calls for applications included several projects in India and Australia, broadening the program's scope into the Asia-Pacific region. This development followed the establishment of the trilateral Supply Chain Resilience Initiative (SCRI) arrangement with Australia, India and Japan.<sup>22</sup> At the second meeting of the SCRI in March 2022, the three countries agreed to "identify key sectors, particularly in manufacturing and services, where the trilateral cooperation could enhance the resilience of supply chain in the sectors, and encouraged further collaboration between Austrade, Invest India and JETRO to promote investment and business in these sectors. The Ministers also affirmed the importance of cooperation with business and academia to promote best practice and to facilitate joint projects for supply chain resilience. Further, the Ministers decided to formulate and promote supply chain principles in the region."

While progress since March has not been announced, the extension of national efforts into bilateral and multilateral initiatives between Asia-Pacific countries is ongoing. Future alignment between the trilateral SCRI and other arrangements between shared common trading partners will likely increase.

### **Sustainable resilient supply chains**

For companies looking to ensure that their supply chains are resilient, making sure they are sustainable is crucial. Climate change means a shifting of trade

<sup>20</sup> Australian Government: Foreign Investment Review Board website. [Find it here](#)

<sup>21</sup> "Successful Applicants Selected for the Program for Promoting Investment in Japan to Strengthen Supply Chains (Second Call)," *Japan Ministry of Economy, Trade and Industry website*, 2 July 2021; "Support Program to Strengthen Overseas Supply Chains. [Find it here](#)

For Demonstration Projects and Project Feasibility Studies." [Find it here](#)

<sup>22</sup> "Joint Statement on the Supply Chain Resilience Initiative by Australian, Indian and Japanese Trade Ministers," *Australian Government Department of Foreign Affairs and Trade website*, 27 April 2021. [Find it here](#)

patterns, so existing trade patterns are not viable in the long term. Further, greening supply chains is part of a wider shift toward a net zero global economy.

But the number of different regulatory regimes in which businesses' supply chains have to operate is becoming more complicated by a number of different factors, including:

- ▶ Carbon-border measures, including the EU's Carbon Border Adjustment Mechanism legislation
- ▶ Corporate reporting (e.g., corporate due diligence in the EU)
- ▶ Deforestation compliance requirements in the US, EU and UK
- ▶ Varying product standards and conformity assessments
- ▶ Private standards and ecolabels

This list provides a broad overview of different sustainability considerations businesses have when looking to make their supply chains more sustainable and resilient.

### Modern slavery and forced labor

Modern slavery exists in all stages of today's global and complex supply chains. In 2016, the International Labour Organization estimated that 40 million people are in modern slavery, 25 million of who are subject to forced labor worldwide, and of them, 16 million are exploited in the private sector.<sup>23</sup>

In 2021, the G7<sup>24</sup> issued a Joint Statement on Forced Labor,<sup>25</sup> which expressed concern around the use of forced labor in global supply chains and acknowledged the role that trade policy and the

multilateral rules-based trading system can play to prevent, identify and eliminate forced labor. While sending a signal to recognize the importance of addressing forced labor at all levels of the global economy, the statement encouraged governments to share relevant data and evidence, risk management tools and best practices and to utilize emerging technologies to improve the traceability of supply chains.

In the UK, a 2021 House of Commons report sets out the need for the UK government to become more active in creating a stronger legal basis to ensure the transparency of supply chains for UK businesses and further questions the timeliness of the Modern Slavery Act (2015) and the subsequent transparency in supply chains legislation.<sup>26</sup> The legislation requires businesses to report on their efforts to identify and address modern slavery risks in their supply chains.

In the meantime, the Biden administration has emphasized the need to make its trade policy "worker-centric." This has presented itself in a number of ways, including through the use of the USMCA<sup>27</sup> rapid-response labor mechanism as well as proposals on forced labor in the World Trade Organization (WTO) Fisheries Subsidies negotiations.

The US Congress unanimously passed the Uyghur Forced Labor Prevention Act in 2021.<sup>28</sup> The law requires importers to evidence that any goods originating in the Xinjiang region of China were not made with forced labor and authorizes customs officials to seize relevant goods at point of entry. As part of the Act's implementation, the Forced Labor Enforcement Task Force (FLETF) has launched the Uyghur Forced Labor Prevention Act (UFLPA)

enforcement strategy,<sup>29</sup> and US Customs and Border Protection has released importer guidance to assist the trade community on its entry into force on 21 June 2022.<sup>30</sup>

### Cybersecurity

The cyber threat landscape is constantly evolving, posing risks and challenges to businesses and policymakers. With supply chains only as strong as their weakest links, increasing supply chain complexity and interdependencies lead to broad attack surfaces and create the opportunity for perpetrators to identify various access paths to selected targets. According to the Captains of Industry cyber resilience report commissioned by the UK Department for Digital, Culture, Media and Sport (DCMS), one-third of leading UK firms take no action to support their supply chain cybersecurity.

Governments and policymakers acknowledged the need to help businesses tackle threats holistically and have taken initiative to safeguard supply chains:

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23 "Forced labour, modern slavery and human trafficking," *International Labour Organization website*. [Find it here](#)

24 *Group of Seven nations: Canada, France, Germany, Italy, Japan, the UK and US.*

25 "G7 Trade Ministers' Statement on Forced Labour," *UK government website*, 22 October 2021. [Find it here](#)

26 "Uyghur forced labour in Xinjiang and UK value chains," *House of Commons Business, Energy and Industrial Strategy Committee*, 17 March 2021. [Find it here](#)

27 US, Mexico and Canada.

28 "H.R.1155 – Uyghur Forced Labor Prevention Act," *US Congress website*, 8 December 2021. [Find it here](#)

29 "Strategy to Prevent the Importation of Goods Mined, Produced, or Manufactured with Forced Labor in the People's Republic of China," *U.S. Department of Homeland Security website*, 23 December 2021. [Find it here](#)

30 "UFLPA Operational Guidance for Importers," *U.S. Customs and Border Protection website*, 13 June 2022. [Find it here](#)



- ▶ The UK's National Cyber Security Centre has developed the Cyber Assessment Framework,<sup>31</sup> providing guidance for organizations to assess their cyber risk management. DCMS is considering mandating compliance with the framework for IT service providers, while renewing procurement rules to help manage security risks. With the view to overhaul relevant legislation, the UK will launch a new national cyber strategy later this year.
- ▶ The US Cybersecurity and Infrastructure Security Agency (CISA) has committed to working with government and industry partners to enhance supply chain resilience.<sup>32</sup> CISA offers a free Cyber Supply Chain Risk Management course for the public.<sup>33</sup> In December 2018, Homeland Security established the Information and Communications Technology (ICT) Supply Chain Risk Management (SCRM) Task Force, launching several public-private working groups to develop consensus risk management strategies.
- ▶ The European Union Agency for Cybersecurity (ENISA) 2021 report on the Threat Landscape for Supply Chain Attacks analyzed 24 recent cyber attacks and revealed that attackers increasingly infiltrate organizations by targeting suppliers.<sup>34</sup> As businesses across supply chains are increasingly reliant on supplier-managed cloud services, attackers focused on suppliers' code in two-thirds of the incidents. The setup of a relevant ad hoc working group aims to engage a broad range of stakeholders and to provide threat analysis on a range of recent challenges posed by artificial intelligence and 5G.

- ▶ Australia's Cyber Security Strategy 2020 set out the investment of AUD\$1.67 billion over the next 10 years to achieve a more secure online world.<sup>35</sup>
- ▶ New Zealand's National Cyber Security Centre has produced a three-step guidance for business leaders and cyber security professionals to identify, assess and manage the cyber risks in supply chains.

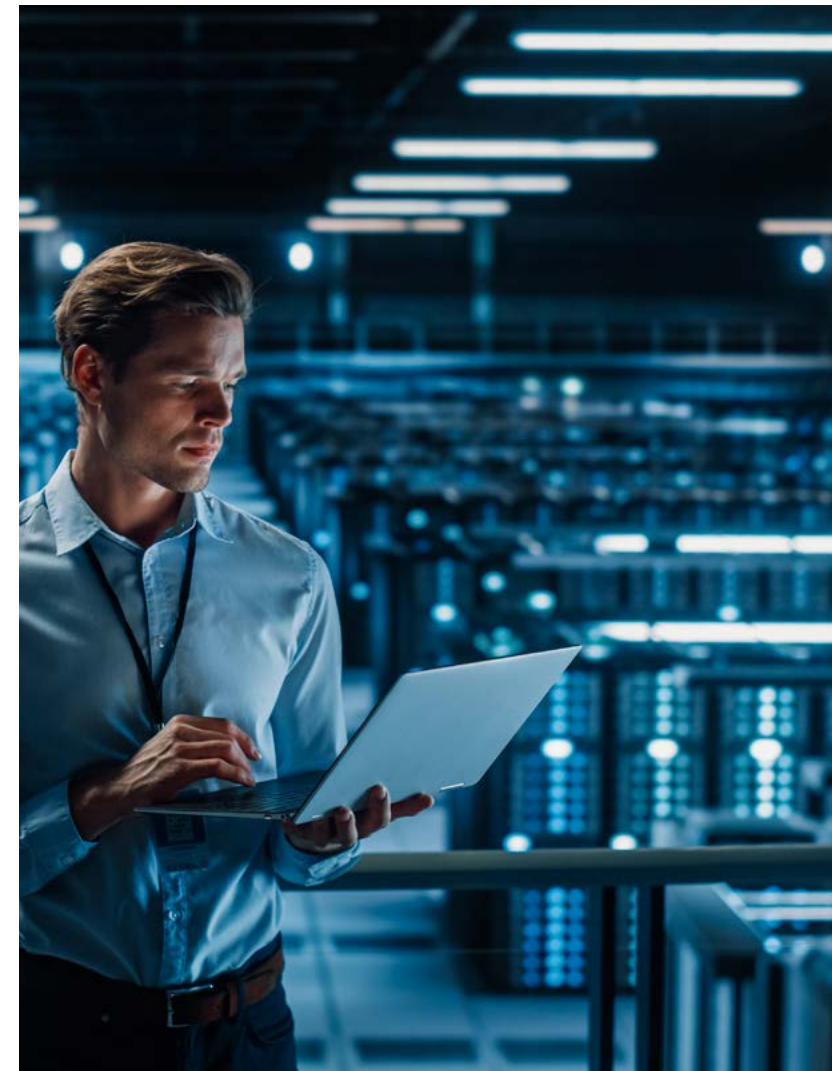
While providing businesses with advice on how to establish good practices and relevant guidance, regulators have recognized the importance of developing relevant legislation to protect consumers and businesses and strengthen national and global cybersecurity in supply chains.<sup>36</sup>

### Food security

As a result of the war in Ukraine, the issue of global food security has rocketed up the agenda in recent months. Both Russia and Ukraine are major players in the production of wheat and other crops as well as major sources of fertilizer for the world.

We have seen calls from the G7, WTO and other international organizations for countries to maintain open and predictable agricultural markets and

trade to ensure the continued flow of food, as well as products, services and inputs essential for agricultural and food production and supply chains. Unfortunately, this has not always been the case, with numerous examples of countries implementing export restrictions on certain agricultural products, including India, Indonesia and Malaysia.



31 "NCSC CAF guidance," *National Cyber Security Centre website*. [Find it here](#)

32 "Information and Communications Technology Supply Chain Risk Management," *Cybersecurity & Infrastructure Security Agency website*. [Find it here](#)

33 "Introduction to Supply Chain Risk Management course," *Federal Virtual Training Environment website*. [Find it here](#)

34 "Understanding the increase in Supply Chain Security Attacks," *ENISA website*, 29 July 2021. [Find it here](#)

35 "Australia's Cyber Security Strategy 2020," *Commonwealth of Australia*, 6 August 2020. [Find it here](#)

36 "Supply Chain Cyber Security: In Safe Hands," *New Zealand National Cyber Security Centre website*. [Find it here](#)

Agricultural supply chains are unique in several different ways, including seasonality, timing and cold-chain requirements. The political implications for governments when agricultural supply chains are threatened is also fundamentally more profound, as civil unrest can quickly spiral into wider national and regional instability.

### Financing resilient supply chains

Governments can readily use their export credit agencies to fund exports and thus boost trade in sectors deemed to be a priority and with countries that are friendly. Returning to the executive action taken by the Biden administration around renewable energy,<sup>37</sup> mentioned earlier, the actions include:

- ▶ The Export-Import Bank of the United States Make More in America Initiative prioritizing investments to expand clean energy manufacturing
- ▶ The U.S. International Development Finance Corporation supporting resilient clean energy manufacturing supply chains in allied nations around the world, with the explicit aim of reducing global dependence on China

The UK, through UK Export Finance, has similarly been using its capacity to boost renewable energy projects, with **£3.6 billion provided** in 2021, up from £2.4 billion in 2020, and ceasing support for oil and gas projects.<sup>38</sup>

### What can multilateralism do for supply chain resiliency?

Though there are many unilateral and bilateral measures for supply chain resiliency being implemented by countries around the world, what role is there for multilateral organizations to play in this space?

Looking at the Organisation for Economic Co-operation and Development (OECD) guide to resilient supply chains, one of its core recommendations was to keep markets open and abide by the terms of countries' various international agreements and commitments.<sup>39</sup> A good example of this was the WTO's Trade Facilitation Agreement, which is designed to cut red tape and bureaucracy at the border. By having transparent, predictable and easy-to-use border procedures, companies can reduce the amount of disruption businesses still feel as a result of the COVID-19 pandemic.

### Will government action make things better or worse?

For many governments, where geopolitical and national security concerns are increasingly taking priority over ease of doing business for companies, simply advocating for more of the same is not going to resonate.

It is not yet clear whether this mix of government policies will yield anything positive. Arguably, a second-best outcome might be that these government policies do not do anything at all, but there is a material risk that they have a negative impact.

In Michael Gasiorek's recent article "Supply Chain Resilience: The dangers of 'pick n mix'," he says policy responses, in many cases, have been designed to protect domestic producers and stifle competition.<sup>40</sup> In the long run, this could mean higher prices for consumers and stifled innovation. In Raghuram Rajan's article "Just Say No to 'Friend-Shoring'," he makes a similar argument – that friend-shoring will lead to higher prices and not much resiliency.<sup>41</sup>

### First steps toward actual supply chain resiliency

As companies look at their supply chains through the geopolitical lens described in this article, it is easy to feel overwhelmed by the sheer complexity and range of measures being implemented around the world.

Business leaders need to start with the assumption that there is a significant likelihood of seeing increased government intervention in their supply chains, limitations on or rejections of cross-border investments, export controls, restrictive trade measures, and greater regulatory scrutiny. With those assumptions, it then becomes possible to acknowledge steps to assess those risks and boost supply chain resiliency.

37 "FACT SHEET: President Biden Takes Bold Executive Action to Spur Domestic Clean Energy Manufacturing," *The White House website*, 6 June 2022. [Find it here](#)

38 "UKEF provides record £3.6bn to help UK businesses construct hospitals, electric railways and offshore wind across the globe," *UK government website*, 8 June 2022. [Find it here](#)

39 "Keys to resilient supply chains: policy tools for preparedness and responsiveness," *OECD website*. [Find it here](#)

40 "Supply Chain Resilience: The dangers of 'pick n mix'," *UK Trade Policy Observatory*, April 2022. [Find it here](#)

41 "Just Say No to 'Friend-Shoring'," *Project Syndicate*, 3 June 2022. [Find it here](#)





The first step as part of this work should include undertaking a detailed supply chain assessment. This isn't simply what is coming from where. Rather, it should be a serious undertaking, sponsored by the leadership of the business, to assess the following risk factors:

- ▶ **Geography:** Identifying which products are over reliant on geographical concentration. This should be mapped against a geopolitical risk profile of those geographies where the business has significant concentration.
- ▶ **Raw materials:** Identifying the critical raw materials for the company's products across the supply chain.
- ▶ **Critical components:** Identifying the critical components for products, with particular attention to components originating from single suppliers and any necessary software and machinery. This should also include a complete overview of any relevant product standards or labeling requirements across different jurisdictions.
- ▶ **Cybersecurity:** Audit cybersecurity protocols and carry out vulnerability testing throughout the supply chain of the business and those of its suppliers.
- ▶ **Capacity:** Stress-test the capacity of the supply chain, logistics and customs business functions to identify whether they can address and navigate high-impact supply chain disruptions.

Businesses are likely to face lower levels of political risk on investments in markets aligned with their home country's bloc. This will apply to both new and existing investments relating to research and development (R&D) collaboration, manufacturing and commercial sales. Where possible, businesses should assess whether they can avail of government subsidies offered to incentivize such moves.

These actions will be particularly crucial for companies in the growing number of sectors deemed strategic for economic or national security reasons, such as semiconductors, computer and telecommunications equipment, electric vehicles (EVs), pharmaceuticals, and critical infrastructure.

### **Key actions for businesses to create supply chain resilience**

The war in Ukraine and geopolitical tensions between the US and China, among other disruptions, are creating significant supply challenges for companies around the world. Establishing long-term supply chain resiliency, which reduces the possible risks described throughout this article, will vary by company, but corporate leaders should have three broad priorities as they adjust to the new geopolitical environment:

#### **1. Assess current and future geopolitical risks.**

Use a structured approach for identifying, monitoring and assessing geopolitical risks arising from long-term changes to the world order, and incorporate these assessments into enterprise risk management (ERM) frameworks, which are aligned with supply chain monitoring. Doing so will provide real-time insights into the supply chain performance.

#### **2. Establish a cross-functional geostrategic team.**

Include representatives from across business functions (including trade strategy, supply chain, customs, logistics, government affairs, legal and finance) to capture the different aspects of supply chain resiliency. This should include C-suite sponsorship and leadership to work across the relevant business functions.

#### **3. Refine company strategy to match new geopolitical realities.**

Conduct a global footprint assessment for geopolitical risks and adjust accordingly, and proactively include geopolitical risk analysis in strategic planning processes, especially supply chain sourcing decisions, grants and incentives, and market-entry strategies. ■



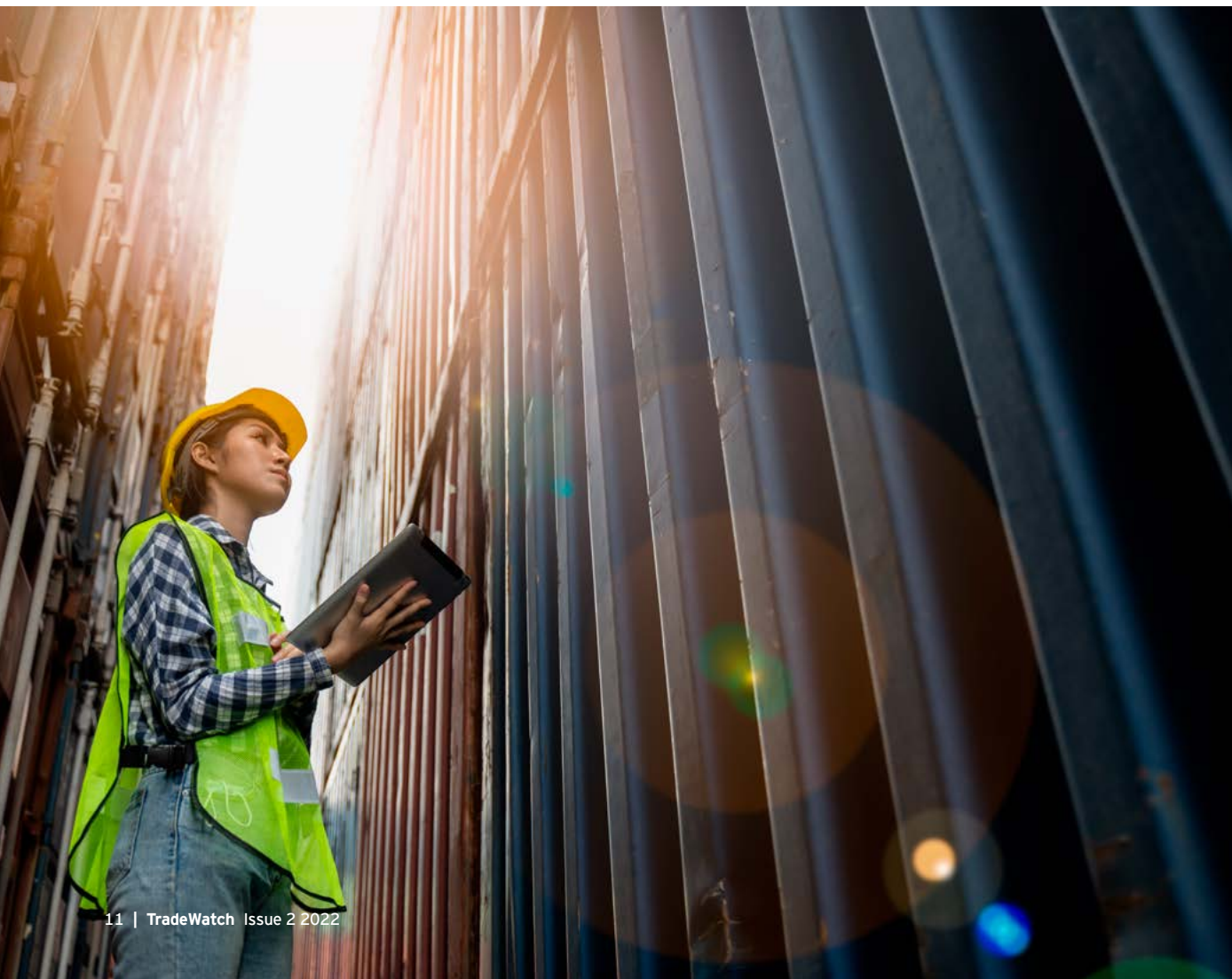
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# Narrowing the gender disparity gap in trade: if not now, when?



Gender has long been a topic in international law and trade, from the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW)<sup>1</sup> to the more recent 2017 World Trade Organization (WTO) Buenos Aires Declaration,<sup>2</sup> but there is continued recognition that these accords need to be strengthened.

As the business community increasingly focuses on social and environmental issues, what are some of the key gaps for women in business? And how can business leaders confirm that the dialogue around gender parity strikes more than just a chord with employees and actually leads to meaningful and sustainable change among those who govern trade mechanisms?

The Global Gender Gap 2021 Report indicates that the gap for economic participation and opportunity will take 267.6 years to close.<sup>3</sup> Many believe that this is too long and that society should act now to close the gender gap in trade, using the gender-specific data that is now readily available to inform and guide better trade strategy decisions.

## The gender representation gap

The World Economic Forum (WEF) has found that around the world women generally have been disproportionately affected by the COVID-19 pandemic compared to men, taking on more

1 UN website. [Find it here](#)

2 "Joint Declaration on Trade and Women's Economic Empowerment on the Occasion of the WTO Ministerial Conference in Buenos Aires in December 2017," *WTO website*. [Find it here](#)

3 "Global Gender Gap Report 2021," *World Economic Forum website*, 30 March 2021. [Find it here](#)

caregiving responsibilities than men and as a result experiencing reductions or adjustments around their paid work.

At a global level in trade, the COVID-19 response presents a case study of gender disparity in representation across the intersections of decision-making in health, trade and politics. Below are several key statistics around the pandemic response:

- ▶ In the global health sector, women hold only 30% of leadership roles.<sup>4</sup>
- ▶ Men hold 82% of the top-grade positions in the WTO.<sup>5</sup>
- ▶ Among approximately 200 governments, only 21% have appointed female ministers.<sup>6</sup>

Studies suggest that women experience more barriers than men to trade in foreign markets in any case. Women (particularly those in developing countries) face inequitable access to finance; a lack of gender diversity in customs facilities; insufficient access to basic information on how to trade; overly bureaucratic requirements to provide evidence; institutional, societal and cultural barriers; and reduced access to skill-building activities at the foundational level across education and digital literacy. In developing countries, the impact of these barriers remains acute for vulnerable households, which tend to benefit more from lower consumer prices gained from trade.

These barriers also have an impact in developed countries. For example, the Organisation for Economic Co-operation and Development (OECD) recently analyzed trade and gender in New Zealand

and found that a 25% increase in New Zealand tariff rates on imported goods would help purchasing power in more vulnerable household types, such as single-parent households with dependent children, most often led by women.<sup>7</sup> In the United Kingdom (UK), the picture is similar. By the end of 2020, there were no longer any Financial Times Stock Exchange (FTSE) 100 companies with all-male boards, and women made up 33% of board positions on FTSE 100 and FTSE 250 boards – an increase of 50% over the last five years.<sup>8</sup> However, despite this progress, equity gaps have been exacerbated by the COVID-19 pandemic, and they threaten to undo the work already done. Before the pandemic, the UK lagged behind its international counterparts in closing the gender pay gap across politics, economics, health and education. These conditions have worsened since the pandemic began, and the WEF noted that the country fell from 15th to 23rd in its Global Gender Gap Report in just two years.<sup>9</sup>

### The business case for change

Despite these stark figures, the business case for gender equality is often overlooked in relation to trade and investment. For example, trade liberalization typically increases women's wages and economic equality. Incentivizing better jobs for women brings them from the informal to the formal sectors, where they enjoy better labor rights and protections. Further, sectors with significant exports bring new jobs that require new skills. For women in developing countries in particular, this can narrow the wage gap. According to the World Bank, if developing countries doubled their manufacturing

exports, women's share of total manufacturing wages would increase from 24% to 30%.<sup>10</sup>

Applying better gender-related data to trade strategy in this area could help address barriers to women's access to markets.

Looking again at the UK, it is the leading European country for starting a business. More than 5.5 million UK businesses (99.9% of the country's business population) are small and medium enterprises (SMEs), which account for half of private sector turnover. Therefore, as the UK's export strategy accelerates, business leaders actively diffusing information on trade facilitation and access to networks to SMEs will be vital to the effort to scale up and ensure a wider awareness of these trade opportunities. An independent review commissioned by the UK Treasury estimated that up to £250 billion of new value could be added to the UK economy if women started and scaled new businesses at the same rate as UK men. Although women represent a third of SME owners in the UK, there is a huge, unrealized opportunity here, and a sharper lens on

- 4 "2021 Global Health 50/50 Report," *Global Health 5050 website*. [Find it here](#)
- 5 "Women and the WTO: Gender Statistics (1995-2016)," *WTO website*, 2017. [Find it here](#)
- 6 "Facts and figures: Women's leadership and political participation," *UN Women website*. [Find it here](#)
- 7 "Trade and Gender Review of New Zealand," *OECD website*, 1 June 2022. [Find it here](#)
- 8 "UK boards meet gender target, but there are still too few women in senior leadership roles – just eight female CEOs in FTSE100," *Ernst & Young LLP*, 7 October 2021. [Find it here](#)
- 9 "Global Gender Gap Report 2021," *World Economic Forum website*, 30 March 2021. [Find it here](#)
- 10 "Women and Trade: The Role of Trade in Promoting Women's Equality," *The World Bank website*, 30 July 2020. [Find it here](#)





gender could be used to enable the scaling up of SMEs owned by women – with potentially significant benefits to the UK economy.

### How do we facilitate change?

#### WTO initiatives

On 12 June 2022, during the WTO Twelfth Ministerial Conference (MC12), the Informal Working Group on Trade and Gender issued a statement<sup>12</sup> reaffirming its commitment to advancing gender equality in trade. The first work plan on trade and gender at the WTO is now underway, focusing on applying a gender lens to WTO policy, supporting the Aid for Trade program and issues related to collecting gender-disaggregated data. The WTO Gender Research Hub will also be launching the first World Trade Congress on Gender in December 2022.<sup>13</sup>

While this progress toward more thorough research is clearly welcome, binding commitments in international agreements, if negotiated and critically enforced between partner countries, may also help address these inequalities. However, gender provisions in international law are often not obligatory, and men dominate the lawmaking structures such as dispute resolution. A 2017 [WTO report](#)<sup>14</sup> highlighted that less than half (123 of

12 "Trade and gender co-chairs affirm commitment to gender equality in trade at MC12," *WTO website*, 12 June 2022. [Find it here](#)

13 "World Trade Congress on Gender: Deadline for submitting papers extended to 1 July," *WTO website*, 4 May 2022. [Find it here](#)

14 "Women and the WTO: Gender Statistics (1995-2016)," *WTO website*. [Find it here](#)

268) WTO dispute panels have included women. Of the panels that included women, only 14% of legal representatives were women and only 6% of panels were chaired by women.

### Trade agreements

For trade policymakers, gender mainstreaming, the public policy strategy to achieve equality among genders, offers a way of integrating gender perspectives into preparation, design and implementation of policies in all political, economic and societal spheres of trade agreements. It can also help with addressing the intersectionality of gender with other identities in trade provisions, such as ethnicity, with migrant women and women with disabilities being particularly disadvantaged. Tackling gender disparities should not be done in isolation, and trade agreements can be key in supporting hard and soft power mechanisms.

An example is the gender equality chapter in the UK-Australia Free Trade Agreement (FTA).<sup>15</sup> It is the first time Australia has included such a chapter, and it commits the signatories to evidence gathering and sharing to increase women's access to markets, leadership networks, finance and education, with a particular focus on science,

technology, engineering and mathematics (STEM). It will also establish a dialogue between government representatives to promote the views of women workers, business owners and entrepreneurs on advancing women's economic empowerment in trade and investment. The chapter should be considered a positive statement of intent; however, successful implementation will require sustained effort.

Though some countries, like Chile, have included gender chapters in FTAs, but as with the UK-Australia agreement, generally trade and gender language reflects only best practices, rather than imposing obligations on companies and governments. Increasing female policymaker representation would support both sharper language and integrating gender perspectives; for example, there could be explicit mandates for equal male and female members on dispute panels or supporting agreement structures, such as a Trade and Gender Committee. While some doubt the extent to which trade agreements can generate immediate results, they can be an effective first step for countries with less gender equity.

Efforts are also underway to promote mutually reinforcing gender and trade policies with international, stand-alone agreements. At MC12, Canada, Chile, Mexico and New Zealand met to welcome Colombia and Peru as the newest members of the 2020 Global Trade and Gender Arrangement, with Argentina and Ecuador also announcing their intention to join.<sup>16</sup> This arrangement builds on previous knowledge-sharing endeavors to establish a more substantive working group to drive new activity and cooperation.

For trade agreements to work in support of gender equality, the marriage of domestic policy with trade and strategic goals is often overlooked. For example, for the UK to achieve its science and technology superpower goal by 2030, it will need to accelerate narrowing the gender gap within the STEM space. Women represent only 24% of all jobs in STEM industries<sup>17</sup> and in engineering account for just 14%.<sup>18</sup> The UK will need a dual approach to nurture and pass on innovative skills to its workforce: ensuring mobility provisions within its trade agreements to attract the best female talent and requiring all education tiers to have a forward-thinking digital and STEM agenda that pursues gender equality.

### Conclusion

The post-COVID-19 landscape presents an ideal opportunity to set the conditions for a fairer, more equitable society. A serious commitment to sustainable trade and business requires actions to progress women's access and representation throughout policy decision-making and in business. The Global Gender Gap Report 2021 indicates the gap for economic participation and opportunity will take 267.6 years to close, highlighting just how much there is to do. So, if not now, when? ■

<sup>15</sup> "Chapter 24: Trade And Gender Equality," *UK government website*, [Find it here](#)

<sup>16</sup> "Ministerial Joint Statement – Inclusive Trade Action Group (ITAG) – Twelfth WTO Ministerial Conference in Geneva, Switzerland – June 13 2022," *New Zealand Foreign Affairs & Trade website*, 14 June 2022. [Find it here](#)

<sup>17</sup> "Statistics," *WISE Campaign website*. [Find it here](#)

<sup>18</sup> "Useful Statistics," *The Women's Engineering Society website*, March 2022. [Find it here](#)

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# What the WTO's 12th Ministerial Conference means for business

On 17 June 2022, World Trade Organization (WTO) members overcame a pessimistic outlook to deliver a series of agreements and decisions at the end of the Twelfth Ministerial Conference (MC12) that together are being called the Geneva Package.<sup>1</sup>

The WTO hailed the meeting outcome as “unprecedented.”<sup>2</sup> It covers a series of decisions on fisheries subsidies, the WTO response to emergencies, food safety and agriculture, and WTO reform. But what does it mean for businesses?

Let's consider each of the measures in the Geneva Package in turn.

## Preventing customs duties on electronic transmissions

WTO members agreed at MC12 to extend the moratorium on imposing customs duties on electronic transmissions until MC13 (expected to take place in December 2023).<sup>3</sup> There was a material risk that this moratorium was not going to be renewed. This had alarmed many services and digital companies that could have, theoretically, faced a whole new raft of customs duties where none had previously been levied.

The extension allows businesses that transfer data across borders a degree of relief (as seen from the Global Services Coalition's response to the news).<sup>4</sup> However, business should not be complacent that this moratorium will necessarily continue indefinitely. A number of WTO members are increasingly reluctant to pay the increasing price of agreeing the moratorium at each successive WTO ministerial conference.



## Eliminating harmful fisheries subsidies

Probably the most significant non-business outcome from MC12 was the Agreement on Fisheries Subsidies, agreed by all WTO members.<sup>5</sup> These negotiations have been ongoing for 20 years and are aimed at eliminating harmful fisheries subsidies in order to halt the decline in fish stocks around the world. In the end, the version that trade ministers agreed on was a slimmed-down version of the draft text that had been negotiated prior to the meeting.<sup>6</sup>

1 “MC12 Outcome Document,” *World Trade Organization*, 22 June 2022. [Find it here](#)

2 “WTO members secure unprecedented package of trade outcomes at MC12,” *World Trade Organization*, 17 June 2022. [Find it here](#)

3 “Work Programme on Electronic Commerce,” *World Trade Organization*, 22 June 2022. [Find it here](#)

4 “Global Services Coalition Congratulates Trade Ministers and applauds extension of the Moratorium on Customs Duties on E-Transmissions at WTO MC12,” *Global Services Coalition press statement*, 17 June 2022. [Find it here](#)

5 “Agreement on Fisheries Subsidies,” *World Trade Organization*, 22 June 2022. [Find it here](#)

6 “WTO Members Clinch a Deal on Fisheries Subsidies,” *Institute for International Sustainable Development website*, 17 June 2022. [Find it here](#)

This leaves unfinished work for countries to continue to improve on in the future, not least ensuring that the agreement is ratified by two-thirds of the WTO membership and enters into force as soon as possible. The agreement was coupled with a new Fisheries Funding Mechanism, which is designed to help developing countries implement the agreement.<sup>7</sup>

For the vast majority of businesses, the WTO Agreement on Fisheries Subsidies will not impact their day-to-day operations in any way. However, it does matter to them for two reasons: first is the totemic importance that these negotiations had taken on for many countries as evidence as to whether the WTO could still deliver; second is the increasing interlinking of trade and environmental issues, which is explored later in this article.

### What's in a TRIPS waiver?

Early on in the COVID-19 pandemic, India, South Africa and other developing countries argued that certain parts of the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS) were prohibiting the dissemination of vaccine technologies and know-how to developing countries and should, therefore, be suspended. Certain countries, most notably the United Kingdom (UK) and Switzerland, disagreed that the TRIPS agreement was causing these problems, a position also shared by many life sciences companies. In the months running up to MC12, a convoluted and confused negotiating process meant that going into the meeting, the status of the negotiating text and possible outcomes were far from certain.

At almost the last moment of the conference, WTO members adopted a Ministerial Decision on the TRIPS Agreement, which allows WTO members to authorize the use of the subject matter contained in a patent relating to COVID-19 vaccines without the consent of the right holder.<sup>8</sup> The decision sets out a number of caveats and procedures for such an authorization and is limited to five years.

7 "WTO Fisheries Funding Mechanism readied to provide support for ending harmful subsidies," *World Trade Organization website*, 14 June 2022. [Find it here](#)

8 "Ministerial Decision on the Trips Agreement," *World Trade Organization*, 22 June 2022. [Find it here](#)

9 "WTO Ministerial Delivers Mixed Results on Business Priorities; Further Action Needed," *U.S. Chamber of Commerce website*, 17 June 2022. [Find it here](#)

The reaction from both nongovernmental organizations and the life sciences sector indicates that not everyone agrees with the decision. Critical comments include:

- ▶ From the US Chamber of Commerce: "Intellectual property rights helped deliver COVID-19 vaccines in record time, and today the world is awash in vaccine doses. We can't let this unfortunate measure set a precedent for undermining IP rights."<sup>9</sup>
- ▶ From the South Centre: "An insufficient multilateral response."<sup>10</sup>

WTO members were also able to adopt a Ministerial Declaration on the WTO Response to the COVID-19 Pandemic and Preparedness for Future Pandemics.<sup>11</sup> It essentially says the WTO should do more in the event of future pandemics and that a stock-taking exercise will be undertaken to assess the response to the COVID-19 pandemic.

For many life sciences businesses, the main concern going forward is that the decision concerns itself with patents for COVID-19 vaccines, but the decision also sets out that no later than six months from the date of the Decision, WTO members must decide whether it should be extended to cover the production and supply of COVID-19 diagnostics and therapeutics, which is potentially a much more significant development.

### Reforming the WTO

While the overall MC12 Outcome Document is short on meaningful statements for business, the one exception to this is paragraph three of the outcome document, which concerns WTO reform.<sup>12</sup>

*"3. We acknowledge the need to take advantage of available opportunities, address the challenges that the WTO is facing, and ensure the WTO's proper functioning. We commit to work towards necessary reform of the WTO. While reaffirming the foundational principles of the WTO, we envision reforms to*

10 "Trips Waiver: An Insufficient Multilateral Response. Trips-Consistent National Actions Are Called For," *South Centre*, 21 June 2022. [Find it here](#)

11 "Ministerial Declaration on the WTO Response to the COVID-19 Pandemic and Preparedness for Future Pandemics," *World Trade Organization*, 22 June 2022. [Find it here](#)

12 "MC12 Outcome Document," *World Trade Organization*, 22 June 2022. [Find it here](#)



*improve all its functions. [...] The General Council and its subsidiary bodies will conduct the work, review progress, and consider decisions, as appropriate, to be submitted to the next Ministerial Conference.”*

WTO reform matters to businesses. Ensuring that the WTO can function and deliver outcomes that support a rules-based trading system are foundational to companies' ability to trade with any sort of certainty and reliability. Following MC12, the International Chamber of Commerce strongly welcomed “ministers responding to the calls of business to properly begin the hard work of reforming all of the WTO's functions.”<sup>13</sup>

While each WTO member undoubtedly has views as to what WTO reform will mean, the fact that this has been acknowledged and a pathway forward has been set is significant. This also includes restoring a fully functional dispute settlement system in the WTO by 2024.



Before moving on to some of the more significant outcomes that took place plurilaterally (or among subsections of the WTO membership), there were a number of other multilateral outcomes, including:

- ▶ Ministerial Declaration on the Emergency Response to Food Insecurity<sup>14</sup>
- ▶ Ministerial Decision on World Food Programme Food Purchases Exemption from Export Prohibitions or Restrictions<sup>15</sup>
- ▶ Sanitary and Phytosanitary Declaration for the Twelfth WTO Ministerial Conference: Responding to Modern SPS Challenges – Ministerial Declaration<sup>16</sup>
- ▶ Work Programme on Small Economies – Ministerial Decision<sup>17</sup>
- ▶ TRIPS Non-violation and Situation Complaints – Ministerial Decision<sup>18</sup>

### Domestic Regulation for Services

At MC12, Georgia, Timor-Leste and the United Arab Emirates announced that they are joining the initiative on Services Domestic Regulation, which successfully concluded negotiations in December 2021.<sup>19</sup>

The declaration was adopted by 67 members (now 70) in December 2021. It set out new disciplines on making the regulatory environment more conducive to business and lowering trade costs for services suppliers seeking to access foreign markets. The new provisions for Services Domestic Regulation should enter into force at the end of 2022. As a result, businesses can look to new opportunities and improved information relating to trade in services.

<sup>13</sup> “ICC welcomes WTO’s responsiveness to business needs,” *International Chamber of Commerce*, 17 June 2022. [Find it here](#)

<sup>14</sup> “Ministerial Declaration on the Emergency Response to Food Insecurity,” *World Trade Organization*, 22 June 2022. [Find it here](#)

<sup>15</sup> “Ministerial Decision on World Food Programme Food Purchases Exemption from Export Prohibitions or Restrictions,” *World Trade Organization*, 22 June 2022. [Find it here](#)

<sup>16</sup> “Sanitary and Phytosanitary Declaration for the Twelfth WTO Ministerial Conference: Responding to Modern SPS Challenges,” *World Trade Organization*, 22 June 2022. [Find it here](#)

<sup>17</sup> “Work Programme on Small Economies,” *World Trade Organization*, 22 June 2022. [Find it here](#)

<sup>18</sup> “Trips Non-violation and Situation Complaints,” *World Trade Organization*, 22 June 2022. [Find it here](#)

<sup>19</sup> “Georgia, Timor-Leste and United Arab Emirates join initiative on services domestic regulation,” *World Trade Organization website*, 13 June 2022. [Find it here](#)

### E-commerce and digital trade

The Joint Statement Initiative (JSI) on e-commerce issued a statement by the co-convenors of the negotiations (Australia, Japan and Singapore) providing an update on its progress.<sup>20</sup> They also launched the E-Commerce Capacity Building Framework to help developing countries seize digital opportunities.

The importance of digital trade and e-commerce to modern businesses and the global economy cannot be overstated. These live negotiations are significant in developing global rules on e-commerce and managing the divergence of different digital standards.

### What about smaller businesses?

At MC12, the JSI on Micro-, Small- and Medium-Sized Enterprises (MSMEs) launched the Trade4MSMES platform.<sup>21</sup> Although still in the process of improvement, the platform provides a wealth of information aimed at helping smaller businesses trade internationally.

### Trade and environment

The interrelationship between trade and the environment is an increasingly important topic.<sup>22</sup> During MC12, the participants of the Trade, Environment and Sustainability Structured Discussions (TESSD) set out the concrete work taking place and the establishment of four informal working groups on environmental goods and services, trade-related climate measures, circular economy and circularity, and subsidies. Separately, additional work is ongoing through the Informal Dialogue on Plastics Pollution and Fossil Fuel Subsidy Reform Initiative. MC12 also saw the launch of a new ministerial coalition of the EU, Ecuador, Kenya and New Zealand to establish a Coalition of Trade Ministers on Climate.<sup>23</sup>

20 "Co-convenors welcome good progress in e-commerce talks, launch capacity-building framework," *World Trade Organization website*, 13 June. [Find it here](#)

21 *Trade4MSMES website*. [Find it here](#)

22 "How sustainable trade can support net zero targets," *EYGM Limited*, 17 June 2021. [Find it here](#)

23 "The EU teams up with Ecuador, Kenya, New Zealand to forge cooperation on trade and climate," *European Commission website*, 13 June 2022. [Find it here](#)

Business engagement in these different trade and environment initiatives has been substantial over the past six months, as the participating WTO members have invited numerous private sector representatives to provide technical inputs into the various discussions. This will continue to be a considerable option for engagement as the negotiations progress.

### Trade and gender equality<sup>24</sup>

The three co-chairs of the Informal Working Group on Trade and Gender – Botswana, El Salvador and Iceland – issued a statement at MC12 highlighting the achievements of WTO members' joint work and reaffirming their commitment to advancing gender equality in trade.<sup>25</sup>

Separately, Canada, Chile, Mexico and New Zealand welcomed Colombia and Peru as the newest members of the Global Trade and Gender Arrangement (GTAGA).<sup>26</sup> The GTAGA is a groundbreaking trade instrument on gender and is designed to support concrete actions and remove barriers to trade to promote women's economic empowerment. Businesses should be including trade issues as part of their diversity and inclusion strategies.

### Incorporating WTO issues into companies' trade strategies

MC12 showed the range of potential trade issues relevant for companies' trade strategies and the opportunities that may be available to them.

While quick progress cannot be expected when dealing with the 164 different governments of the WTO, neither should stasis be expected, as MC12 has demonstrated. Therefore, businesses can make the WTO part of their long-term strategic trade planning in three ways:

24 See the article "Narrowing the gender disparity gap in trade – if not now, when?" by Sally Jones in this publication, [page 11](#).

25 "Trade and gender co-chairs affirm commitment to gender equality in trade at MC12," *World Trade Organization website*, 12 June 2022. [Find it here](#)

26 "Ministerial Joint Statement – Inclusive Trade Action Group (ITAG) – Twelfth WTO Ministerial Conference in Geneva, Switzerland – June 13 2022," *New Zealand Foreign Affairs & Trade website*, 14 June 2022. [Find it here](#)



### 1. By building a detailed understanding of the WTO

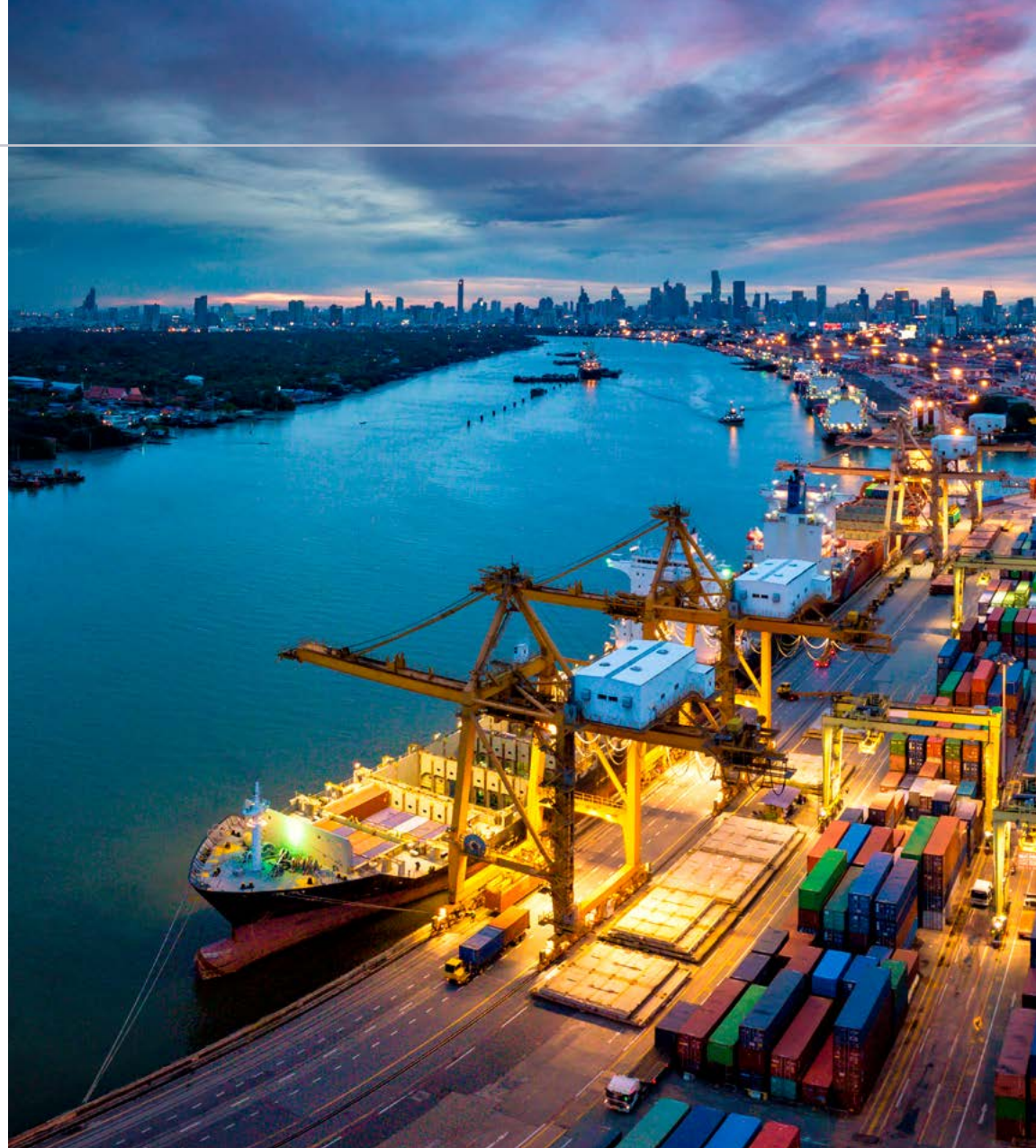
To benefit from the trade opportunities that are opening up around the world, it is important that businesses have a comprehensive understanding of WTO trade rules and processes and make it a core part of their long-term trading strategies. Among other advantages, mastering these rules can empower businesses to shape the right responses to shifting global tariffs and trading relationships; reduce risks, costs and delays in their trade networks; make the best use of their supply chain operating models; and take full advantage of increasingly sophisticated and powerful digital technologies.

### 2. By drawing on the WTO's vast institutional knowledge

The WTO is a rich source of information that can help businesses to build a trade strategy that meets their objectives. It has numerous trade databases filled with information ranging from the tariffs in a particular country to lists of the most recent trade-related standards and regulations being implemented by WTO members. Having access to the right advice and support is critical to navigating the global trade landscape.

### 3. By including the WTO when engaging governments

Experience shows that a well-informed business community can play a significant part in influencing its government's position on trade issues, for example, in the fields of e-commerce or trade and the environment. By including the WTO and the different initiatives underway on the agenda when engaging with governments, businesses have a real opportunity to shape the way their countries will trade in the global economy. ■



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# G7 Trade Ministers' key statement on global trade issues



The Trade Ministers from the Group of Seven (G7) countries<sup>1</sup> met on 14 and 15 September 2022 to discuss and exchange views and ideas on approaches and joint responses to global economic disruptions, trade frictions and rising challenges for global trade. On 15 September 2022, the ministers issued a statement that touched on a number of key issues affecting international trade<sup>2</sup>.

## The war in Ukraine

The ministers condemned Russia's actions in Ukraine and renewed their commitment to sanctions, the suspension of the Most-Favored-Nation treatment for products from the Russian Federation and to coordinating efforts in the relevant G7 working groups on measures affecting trade with Russia. The statement noted that the war has triggered disruption in agricultural production, supply chains and trade, causing particular concern for developing and least developed countries. The ministers stated their commitment to keeping food and agricultural markets open, transparent, and predictable and they called on all partners to avoid unjustified restrictive trade measures. In this context, the ministers welcomed the Ministerial Declaration on the emergency response to food insecurity adopted at the 12th Ministerial Conference of the World Trade Organisation (WTO)<sup>3</sup>. They also reaffirmed their support for the government and people of Ukraine and committed to supporting Ukraine's reform and recovery efforts through trade.

## Reforming the WTO and modernizing its rulebook

The ministers reaffirmed a commitment to reviving and reforming the rules-based multilateral trading system with the World Trade Organization (WTO) at its core and their intention to working together with the aim of reforming the WTO and improving the WTO rulebook. They expressed the view that the global trade rulebook must enable economic transformation, promote sustainable, inclusive, and resilient growth, and be responsive to the needs of people globally. The ministers said that the 12th WTO Ministerial Conference (MC12) has demonstrated that the WTO can deliver meaningful results as the global rulemaking organization on trade by providing responses to today's challenges such as sustainable development, the future of our oceans, the continued health crisis, and the food security crisis. They committed to engaging constructively on ideas to reform all functions of the WTO as agreed at MC12, with a view to achieving concrete progress by MC13. They also committed to finding a permanent solution to the Moratorium on Customs Duties on Electronic Transmissions and reiterated their commitment to the G7 Digital Trade Principles as adopted in 2021 to create open digital markets and data free flows with trust.

1 The G7 countries in 2022 are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

2 "G7 Trade Ministers Statement", *Office of the United States Trade Representative website*, 15 September 2022. [Find it here](#)

3 See the article "What the WTO's 12th Ministerial Conference outcomes mean for business" in this publication, [page 15](#).





### Resilient and sustainable supply chains

The ministers noted diversifying trade and expanding trading relations on a mutually beneficial basis is key to ensuring well-functioning supply chains and to improving the resilience and sustainability of global economies. They said that they will continue to seek new opportunities to work together to support supply chain robustness, as well as to enhance existing collaboration by continuing to share insights and best practices on mechanisms for identifying, monitoring, and minimizing market vulnerabilities and potential logistical bottlenecks in advance of shocks. This includes addressing export restrictions and trade barriers at the international level.

The ministers believe that trade and trade policy can be drivers for environmental and social sustainability. In this context, the G7 will actively engage in the discussions at the WTO, including

on facilitating trade in environmental goods and services, on promoting the circular economy, and on how trade-related climate measures and policies can best contribute to climate and environmental goals and to meeting Paris Agreement and Glasgow Pact commitments while being consistent with WTO rules and principles.

The statement went on to recall the G7 Leaders' Communique of June 2022 and the G7 Trade Ministers' Statement on Forced Labor in October 2021. The ministers recommitted to taking measures to strengthen cooperation and collective efforts towards eradicating the use of all forms of forced labor and child labor in global supply chains, including measures that promote corporate due diligence, and will enhance predictability and certainty for businesses.

### Levelling the playing field and addressing economic coercion

The ministers said they will step-up efforts to work toward creating a level playing field in trade. Shared concerns include unfair practices, such as all forms of forced technology transfer, intellectual property theft, lowering of labor and environmental standards to gain competitive advantage, market-distorting actions of state-owned enterprises, and harmful industrial subsidies, including those that lead to excess capacity. They will also promote discussions at the WTO on how to improve transparency to shed light on and reduce challenges posed by non-market policies and practices that harm the global economy, and on modernizing the global trade rulebook. The use of trade-related economic coercion is a particular concern, as it undermines economic security, free and fair trade in the multilateral trading system, global security and stability and aggravates international tension. To fight attempts at economic coercion, the ministers will enhance cooperation and explore coordinated approaches to address economic coercion both within and beyond the G7 in relevant fora to improve assessment, preparedness, deterrence, and response to such actions. ■

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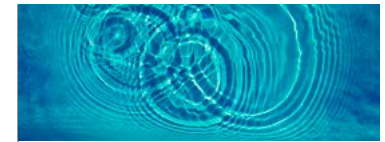
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# US: Developments in export controls and sanctions

The export controls and sanctions regulatory landscape in the United States (US) continues to evolve in response to the war in Ukraine, new and emerging technologies, and increasingly complex global commerce. Companies in all industries could be impacted by export controls and sanctions regulations. Monitoring for changes and potential impact is essential to stay compliant.

Among the key recent developments in the export controls and sanctions space is new guidance from the US government addressing the ban on new investment in Russia, a finalized rule on export controls and authorizations for cybersecurity items, and a pilot authorization program for defense trade exports that can potentially clear the way for additional defense trade with Canada, Australia

and the United Kingdom (UK). Each of these developments is further detailed here.

## **New guidance on Russia investment ban**

On 6 June 2022, the US Department of the Treasury, Office of Foreign Assets Control (OFAC) published new frequently asked questions (FAQs) offering clarification on terms and other guidance related to recent bans on investment in Russia.<sup>1</sup> The bans, implemented in March and April 2022 under Executive Orders 14066, 14068, and 14071 (collectively, EOs), posed challenges regarding the meaning of certain terms, and the FAQs are welcome guidance from OFAC. In addition to defining the term “new investment” – a critical definition for compliance with the investment ban – the FAQs further clarify the types of activities that are prohibited.

Regarding the meaning of the term “new investment,” FAQ 1049 states that the term means “the commitment of capital or other assets for the purpose of generating returns or appreciation,” which occurred “on or after the effective date” of the related EOs (i.e., 8 March, 11 March and 6 April 2022). The FAQ goes on to state, “As a general matter, new investment includes such commitments that are pursuant to an agreement entered on or after the effective dates of the respective E.O. prohibitions. New investment also includes such commitments pursuant to the exercise of rights under an agreement entered into before the effective dates of the respective E.O. prohibitions, where such commitment is made on or after the effective dates of the respective E.O. prohibitions.”



<sup>1</sup> “Frequently Asked Questions,” *US Department of the Treasury website*, 6 June 2022. [Find it here](#)



FAQ 1049 provides the following examples of new investments:

- ▶ The purchase or acquisition of real estate in Russia, other than for noncommercial, personal use
- ▶ Entry into an agreement requiring the commitment of capital or other assets for the establishment or expansion of projects or operations in Russia, including the formation of joint ventures or other corporate entities in Russia
- ▶ Entry into an agreement providing for the participation in royalties or ongoing profits in Russia
- ▶ The lending of funds to persons located in Russia for commercial purposes, including when such funds are intended to be used to fund a new or expanded project or operation in Russia
- ▶ The purchase of an equity interest in an entity located in Russia
- ▶ The purchase or acquisition of rights to natural resources or exploitation thereof in Russia

FAQ 1049 also gives examples of transactions that are not considered a new investment, including examples related to entering into and performing contracts for sale or purchase, as well as maintenance of investments made prior to the effective date of the respective EO prohibitions.

FAQ 1050 offers clarification on transactions within the meaning of maintenance activities described in FAQ 1049, which are therefore outside the scope of prohibitions around new investment. Included within maintenance are “all transactions ordinarily incident to performing under an agreement in effect prior to the effective date of the respective EO prohibitions ... provided that such transactions are consistent with previously established practices and support pre-existing projects or operations.”

FAQ 1054 clarifies how the EOs also prohibit US persons from purchasing new and existing debt and equity securities issued by an entity in Russia, although US persons are not required to divest such securities and may continue to hold them.

Although these are among the key FAQs from June 2022, companies impacted by the Russian investment prohibitions should carefully read FAQs 1049 through 1055 for additional details.

### **Finalization of rule for cybersecurity exports**

On 26 May 2022, the US Department of Commerce, Bureau of Industry and Security (BIS), issued a final rule that confirms changes to two export license exceptions, Authorized Cybersecurity Exports (ACE), and Encryption Commodities, Software, and Technology (ENC), as well as other related changes to the Export Administration Regulations (EAR).<sup>2</sup> The final rule was effective upon publication on 26 May 2022, amending the interim final rule published on 21 October 2021, which went into effect on 7 March 2022.

The interim rule implemented new controls on certain cybersecurity items that can be used for malicious cyber activities, including intrusion software. According to BIS, the “items warrant controls because these tools could be used for surveillance, espionage, or other actions that disrupt, deny or degrade the network or devices on it.” The interim rule also created license exception ACE, which may authorize exports, re-exports, and in-country transfers of certain cybersecurity items to most destinations except in certain cases.

Among the changes in the final rule are the following:

- ▶ Adding a new end-use restriction to license exception ENC<sup>3</sup> which aligns with restrictions in license exception ACE and closing an unintended loophole
- ▶ Limiting the scope of license exception ACE with respect to government end users
- ▶ Clarifying the meaning of “government end user” under license exception ACE and providing an illustrative list of users who meet the definition, as well as defining “partially operated or owned by a government or governmental authority”
- ▶ Restoring the Export Control Classification Number (ECCN) 5D001.e, which was inadvertently removed in the 21 October 2021 interim final rule

<sup>2</sup> See 1 Fed. Reg. 31,948 (May 26, 2022) (BIS final rule on cybersecurity items).

<sup>3</sup> License Exception ENC authorizes export, re-export, and transfer (in-country) of systems, equipment, commodities, and components therefor that are classified under ECCN 5A002, 5B002, equivalent or related software and technology therefor classified under 5D002 or 5E002, and “cryptanalytic items” and digital forensics items (investigative tools) classified under ECCN 5A004, 5D002 or 5E002



Companies engaged in the export, re-export, or in-country transfer of cybersecurity and encryption items should carefully review the 26 May 2022 final rule for potential impacts to business operations, as well as possible benefits in the broad applicability of license exception ACE.

### **Pilot program for general license of defense exports**

On 20 July 2022, the US Department of State, Directorate of Defense Trade Controls (DDTC), published a new pilot program for the general licensing of certain transactions, marking a shift

in the agency's authorization approach, which may benefit exporters of items controlled under the International Traffic in Arms Regulations (ITAR). Previously, ITAR-controlled items were only authorized for export, re-export or retransfer under DDTC licenses, agreements, exemptions, and general correspondence letters.

In this pilot program, DDTC published two open general licenses (OGLs), which authorize certain re-exports and retransfers (but not exports) of unclassified defense articles to the governments of, and certain persons within, Australia, Canada, and the UK, subject to conditions of the OGLs.<sup>4</sup> The OGLs are valid for one year, effective 1 August 2022 through 31 July 2023.

OGL 1 authorizes retransfer (change in end user or end use, or temporary transfer to a third party, of a defense article within a non-US country) of unclassified defense articles to the governments of Australia, Canada, and the UK, as well as members of the Australian and UK communities (i.e., specific Australian and UK government and nongovernment entities authorized under ITAR exemptions for Australia and the UK found under 22 C.F.R. § 126.16 and 22 C.F.R. § 126.17) and Canadian-registered persons under the ITAR's Canadian exemption found at 22 C.F.R. § 126.5.

OGL 2 authorizes the re-export (shipment or transmission of a defense article from one non-US country to another) of unclassified defense articles to and among the same parties as those in OGL 1.

Both OGLs have various conditions, including the below, among others:

- ▶ Defense articles to be authorized under the OGLs must have been originally exported from the United States under a DDTC license or other approval.
- ▶ Ineligible items include classified defense articles, defense articles exported under the Foreign Military Sales (FMS) program, and defense articles listed on the Missile Technology Control Regime (MTCR) Annex or identified as Missile Technology (MT) on the US Munitions List (USML).
- ▶ Technical data may only be authorized for organization-level, intermediate-level, or depot-level maintenance, repair, or storage of a defense article.

Companies planning to use the OGLs should carefully review the authorizations. As with much of ITAR-controlled activity, exporters must follow ITAR recordkeeping requirements when utilizing the OGLs.

DDTC may potentially extend the authorization validity. In addition, DDTC may expand the OGL program to additional ITAR-controlled activities. ■

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<sup>4</sup> See 1 Fed. Reg. 43,366 (July 20, 2022) (created OGLs 1 and 2 under the pilot program). See also DDTC summary of the OGL program, *DDTC website*. [Find it here](#)



## US: Ready-to-drink alcoholic beverages – new classifications enable substitution drawback



The fastest-growing segment of alcoholic beverages is ready-to-drink (RTD) beverages packaged in single-serving containers for immediate consumption. Under the Harmonized System (HS) nomenclature, malt-based RTDs (e.g., hard seltzers) are classified in HS 2206.00, "Other fermented beverages." Spirits-based RTDs (e.g., vodka sodas) are classified in HS 2208.90, "Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 percent vol.; spirits, liqueurs and other spirituous beverages: Other."

The US tariff, also known as the Harmonized Tariff Schedule of the United States (HTSUS), follows the six-digit classification established by the Harmonized System and adds four additional digits. Digits 7 and 8 are established by Congress and used to set tariff rates; digits 9 and 10 are statistical suffixes that can be adjusted by a congressionally established committee, the Committee for Statistical Annotation of the Tariff Schedules, commonly referred to as the 484f Committee.<sup>1</sup> The 484f Committee is authorized to update ninth and tenth digits twice a year and may do so on its own accord or on petition from an interested party.

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<sup>1</sup> 19 USC §1484(f)

Effective 1 July 2022, the 484f Committee approved new 10-digit classifications for both malt-based and spirits-based RTDs.<sup>2</sup> The following tables show both the old and new classifications.

HTSUS for RTDs prior to 1 July 2022	
Malt based	
2206.00	Other fermented beverages (for example, cider, perry, mead, sakè); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included:
2206.00.90.00	Other
Spirit based	
2208	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 percent vol.; spirits, liqueurs and other spirituous beverages:
2208.90	Other
2208.90.80.00	Other

HTSUS for RTDs effective 1 July 2022	
Malt based	
2206.00	Other fermented beverages (for example, cider, perry, mead, sakè); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included:
2206.00.90	Other
	Mixtures of fermented beverages and non-alcoholic beverages, ready to consume as packaged, in containers each holding not over 4 liters:
.10	In aluminum containers
.20	Other
	Other:
.30	In aluminum containers
.40	Other
Spirit based	
2208	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 percent vol.; spirits, liqueurs and other spirituous beverages:
2208.90	Other
2208.90.80	Other
.10	Premixed cocktails or other mixed beverages, ready to consume as packaged, in containers each holding not over 4 liters
.20	Other

Information on US imports is publicly available based on 10-digit HTSUS categories. These new classifications will allow US imports of RTDs to be specifically tracked by interested parties.

### Substitution drawback enabled

The new 10-digit breakouts will also enable duties, fees and excise taxes paid on the import of an RTD to be recovered upon the export of a different RTD with the same 10-digit classification; any malt-based RTD exported will allow recovery of duties, fees and taxes paid on the import of a malt-based RTD, and any export of a spirits-based RTD will allow recovery of duties, fees and taxes paid on the import of a spirits-based RTD.

Drawback is the recovery of duties, fees and taxes paid on an import upon the exportation of that import, a product made with the import, or a production that is of like kind with the import. When a like-kind product is exported, drawback is referred to as substitution drawback. The definition of like-kind was changed in 2016 to be generally based on the eight-digit HTSUS classification of the imported and exported products.<sup>3</sup> However, there is a restriction if the eight-digit classification begins with the word “other.” In that event, imported and exported goods must match at the 10-digit HTSUS, and the 10-digit HTSUS cannot begin with the word “other.”<sup>4</sup> The intent of this restriction is to focus on matching products that are like-kind, rather than allowing any products in a broad basket HTSUS to be considered like-kind.

<sup>2</sup> “Harmonized Tariff Schedule (2022 Revision 8),” *US International Trade Commission website*. [Find it here](#)

<sup>3</sup> Drawback provisions are in 19 USC §1313. Substitution drawback provisions are in 19 USC §1313(j)(2)

<sup>4</sup> 19 USC §1313(j)(5)





US alcoholic beverage producers have been significant beneficiaries of substitution drawback, as the export of a US-made alcoholic beverage enables drawback of duties, fees and excise taxes paid on the import of the same type of beverage. However, RTD producers had previously not been eligible for drawback because of the restriction described above. With the new 10-digit breakouts for RTDs, substitution drawback applies. As an example, an exporter of a margarita RTD can recover the duties, taxes and fees paid on an imported gin and tonic RTD, as both are spirits based.

#### **Implications for importers and exports**

The new HTSUS provisions for RTDs are currently effective and provide importers and exporters of RTDs immediate opportunity for substitution drawback. The RTD classification changes are also a good reminder to all importers and exporters that there are options to enable substitution drawback when the current restriction applies. With an appropriate business case, the 484f Committee will consider new 10-digit breakouts that can enable substitution drawback. ■

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# China: Pilot program for collaborative management of transfer pricing and customs values in Shenzhen

## Background

The Chinese customs and tax authorities in Shenzhen issued a notice, the Collaborative Management of Transfer Prices of Related-Party Imported Goods (the Notice), on 18 May 2022. The Notice took effect on the same date, setting out a pilot framework for taxpayers to acquire certainty from both the customs and tax authorities of Shenzhen on the transfer price and customs value of an import transaction established between related parties. This is a significant move by the Chinese Customs and State Tax Administration (STA) in driving collaborative efforts on the customs valuation/transfer pricing topic.

According to the Notice, the key procedures of this pilot program involve three major steps:

1. An application from enterprise
2. Joint evaluations
3. The signing of a memorandum



The requirements for the collaborative management are further described below:

	Requirements/details
<b>Scope</b>	<ul style="list-style-type: none"> <li>▶ The transfer price of import transactions between related parties</li> </ul>
<b>Applicant</b>	<p>The enterprise meets the requirements of both Article 4 of General Administration of Customs (GAC) Decree No.236 and Article 4 of STA Bulletin No.64:</p> <ul style="list-style-type: none"> <li>▶ It is engaged in exports and imports, and registered with China Customs as a cross-border trading operator</li> <li>▶ It is engaged in related-party transactions of over RMB 40 million for each of the past three years</li> </ul>
<b>Competent authorities</b>	<ul style="list-style-type: none"> <li>▶ <b>Customs</b> – The General Operations section of local customs</li> <li>▶ <b>Tax</b> – The General Operations section of Unit 4 of the Shenzhen Tax Bureau</li> </ul>
<b>Documentation</b>	<ul style="list-style-type: none"> <li>▶ An application for collaborative management of the transfer price of related-party imported goods</li> <li>▶ An application to Customs for an advance ruling on import pricing</li> <li>▶ An application to the Tax Bureau for an advance pricing arrangement pre-filing meeting</li> <li>▶ Other relevant documents</li> </ul>
<b>Time limits</b>	<ul style="list-style-type: none"> <li>▶ <b>Acceptance:</b> confirmed jointly by the customs and tax authorities within 10 days of an application</li> <li>▶ <b>Evaluation:</b> initiated jointly by customs and tax authorities within 15 days of acceptance of the application</li> <li>▶ <b>Memorandum renewal:</b> an application to be filed within 90 days before the expiry of the current memorandum</li> </ul>
<b>Implementation</b>	<ul style="list-style-type: none"> <li>▶ A Memorandum on Collaborative Management signed by Shenzhen customs and tax authorities and the taxpayer</li> <li>▶ An advance ruling on import pricing issued by Shenzhen Customs</li> <li>▶ An advance pricing arrangement agreed between the Shenzhen Tax Bureau and the taxpayer</li> <li>▶ Customs and tax authorities to follow their respective procedures if the taxpayer makes adjustment to its transfer prices, as agreed in the memorandum</li> </ul>
<b>Follow-up</b>	<ul style="list-style-type: none"> <li>▶ <b>Annual update:</b> the taxpayer must update both the customs and tax authorities about the actual implementation and consequential outcome within six months after closing of each fiscal year</li> <li>▶ <b>Evaluation:</b> both the customs and tax authorities will conduct evaluations based on the annual update provided by the taxpayer and implement the relevant treatment or procedure accordingly</li> </ul>

In general, the above framework set out in the Notice is consistent with the existing transfer pricing advance pricing agreement mechanisms of the tax authority and the existing advance ruling mechanism of China Customs, but it is the first time that the two authorities are collaborating with each other on this potentially controversial technical topic from very different technical angles.

## Key implications

The Notice is currently only applicable in Shenzhen. However, the implications of the Notice may extend to other regions or cities of the country. Below are some key implications:

- ▶ The Notice is the first stand-alone regulation released by China Customs for a systematic approach in managing the transfer price of import transactions between related parties.
- ▶ This endeavor is the first time formal collaboration has been established between the Chinese Customs and tax authorities in setting out regulations and procedures on the topic of customs valuation and transfer pricing, although differences in their respective points of view and assessment approaches on this topic will likely still remain.
- ▶ The introduction of this pilot for a collaborative management program may impose additional requirements on taxpayers for compliance in terms of managing their transfer prices collectively from both a tax and customs perspective going forward.



- ▶ The Notice provides an avenue for taxpayers to obtain a joint pre-assessment from both authorities on the transfer price of import transactions made between related parties. This could help taxpayers enhance their transfer pricing and customs valuation compliance, effectively reducing the risks of scrutiny coming from both customs and tax authorities.
- ▶ The Notice sets out the compliance procedures for adjustments of transfer prices post-transaction. It also states that the taxpayer can sign a memorandum with China Customs and the tax authorities to agree transfer pricing of customs values between related parties and then adjust the prices going forward based on the agreed terms in the memorandum.

Based on the sample memorandum released together with the Notice, we also observed the following points on the implementation of the agreement:

- ▶ The collaborative management memorandum, once signed by the importer with the customs and tax authorities, will be effective for three years.
- ▶ The taxpayer's transfer prices shall target the median value of the agreed financial indicator selected for evaluating the transaction(s).
- ▶ If the taxpayer's transfer prices fall below or rise above the median value, the taxpayer shall adjust its transfer prices to the median value.

### Actions for business

China Customs and the tax authorities may issue separate regulations on operational measures with details on implementing the Notice, including for the reconciliation of transfer price evaluations from a tax and customs perspective. In addition, it remains to be seen whether the policy would extend to other regions or cities in the country.

This development signals increased scrutiny from China's customs and tax authorities on the transfer price of import transactions between related parties. Taxpayers should review their transfer pricing policies and monitor the progress of this development in other parts of the country.



Taxpayers in Shenzhen should perform a cost-benefit assessment to determine whether to apply for this collaborative management as set out in the Notice. Other taxpayers may also want to consider exploring the feasibility locally as customs and tax authorities in locations outside Shenzhen are likely to be interested in replicating this pilot program in their own jurisdictions. ■

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# EU: CJEU rules on the liability of indirect customs representative for import VAT

The Commissione tributaria provinciale di Venezia, Italy (Venice Customs Office) has requested a preliminary ruling from the European Court of Justice (CJEU) in the case of U.I.<sup>1</sup> The request concerns the question of whether an indirect customs representative can be held liable for import VAT.

## Relevant facts and circumstances

U.I., a company established in Milan (Italy), acted as an indirect customs representative for several companies. The Venice Customs Office reassessed, respectively, 45 and 115 import declarations of the represented companies. U.I. was then issued two tax notices for the amounts of import VAT payable plus interest and was held jointly and severally liable by the Venice Customs Office for the payment of the import VAT, based on Articles 77 and 84 of the Union Customs Code (UCC).

The reassessment was based on the Venice Customs Office's finding that the importing companies had not met the criteria to apply the VAT-free purchase quota. As a result, the underlying transactions of the import declarations that the Venice Customs Office verified were not exempt from VAT in accordance with local VAT legislation.



## U.I.'s perspective

U.I. filed an appeal against both tax notices it received and requested they be declared unlawful. In its appeal, U.I. argued that, while it did act as an indirect customs representative based on a valid power of attorney, Articles 77 and 84 of the UCC were not applicable to VAT and that the Italian legal framework does not contain a provision that makes the indirect customs representative jointly and severally liable for the payment of import VAT.

## Italian Customs Agency's perspective

The Italian Customs Agency requested that U.I.'s appeal be dismissed. According to the former, the chargeable event for the import VAT debt was importation, which is an event that is identified in the customs regulations. Those regulations should also be used to determine the origin of the import VAT debt and, therefore, to establish that the debtors are the persons presenting the goods to customs in line with the case law of the Corte suprema di cassazione (Supreme Court of Cassation, Italy), the importer and its indirect customs representative, jointly and severally.

<sup>1</sup> CJEU 12 May 2022, C-714/20 (U.I.), ECLI:EU:C:2022:374



### Request for preliminary ruling

The Venice Customs Office decided to stay the procedure and asked the following questions to the CJEU:

1. Whether Article 201 of the VAT Directive must be interpreted as meaning that an indirect customs representative can be held jointly and severally liable with the importer for the payment of import VAT where there are no national provisions expressly designating or recognizing that representative as being liable for that tax.
2. Whether Article 77(3) of the Customs Code must be interpreted as meaning that, under that provision alone, the indirect customs representative is liable for the customs duties payable on the goods it has declared to customs and for the import VAT on those goods.

Concerning the second question, the CJEU notes that while customs duties and import VAT have comparable essential features (e.g., chargeable events), Article 201 of the EU VAT Directive leaves it up to the discretion of the Member States to designate the persons liable to pay import VAT. As such, the CJEU rules that Article 201 of the EU VAT Directive must be interpreted as meaning that the liability of the indirect customs representative for the payment of the import value added tax, jointly and severally with the importer, cannot be accepted if no national provisions explicitly and unequivocally designate or recognize that representative as being liable for that tax.

The CJEU also states that, in the context of the second question, an indirect customs representative is identified as a debtor according to Article 77(3) of the UCC together with the person on whose behalf the customs declaration is made. According to Article 5(19) of that code, the debtor is “any person liable for a customs debt.” Article 5(18) of the UCC defines customs debt as the obligation on a person to pay the amount of “import or export duty which applies to specific goods under the customs legislation in force.” However, import VAT is not included as an import duty under Article 5(20) of that code, which covers customs duty payable on the import of goods. Consequently, the CJEU rules that Article 77(3) of the UCC must be interpreted as meaning that, under that provision alone, the indirect customs representative is liable only for the customs duties payable on the goods they have declared to customs, and not also for the import VAT on those goods.



### Actions for businesses

The determination of whether an indirect customs representative can be held liable for EU import VAT (in addition to customs duties) depends on whether the Member State of import identifies the former explicitly and unequivocally as such in its local legislation. While import VAT is generally recoverable by taxable persons entitled to full input VAT deduction, EU Member States may argue that if goods are not destined or owned by a party, the latter is not entitled to deduct the import VAT. Importers, parties offering indirect customs representation services and others involved in the import of goods into the EU should verify whether they can be held (jointly and severally) liable for import VAT in the EU Member State of import. Parties can then take the necessary steps to reflect this liability in their contractual arrangements (e.g., by incorporating appropriate provisions on redress in case of liability). ■

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# EU: CJEU rules on use of statistical data for determination of customs value

On 9 June 2022, the European Court of Justice (CJEU) published its decisions in two court cases, *Baltic Master*<sup>1</sup> and *Fawkes*.<sup>2</sup> In these two cases, the CJEU ruled on the use of statistical values for determining the customs value.

## **Baltic Master**

### **Background**

*Baltic Master* imported various quantities of goods purchased from Gus Group into Lithuania between 2009 and 2012. The goods originated from Malaysia and were presented as parts of air-conditioning

machines in the customs declaration. In the declaration, only one TARIC code<sup>3</sup> was used for these goods and the transaction value of the goods was used to determine the customs value.

During an inspection, the Lithuanian customs authorities were of the opinion that the description of the goods was incorrect and that the goods should have been declared under another TARIC code. Additionally, due to the nature of the business relationship between *Baltic Master* and Gus Group, the transaction should have been regarded as one taking place between related persons. The customs value should then be determined on the basis of the data available in the national authorities' customs information system since the customs value could not be determined by the other valuation methods.

During the appeal process, the Supreme Administrative Court of Lithuania asked for a preliminary ruling and brought two questions before the CJEU. The first question concerns the interpretation of the related person provision, and the second question is whether the customs



1 CJEU 9 June 2022, C-599/20 (*Baltic Master*), ECLI:EU:C:2022:457

2 CJEU 9 June 2022, C-187/21 (*Fawkes*), ECLI:EU:C:2022:458

3 The TARIC code (TARif Intégré Communautaire; Integrated Tariff of the European Communities) is designed to show the various rules applying to specific products when imported into the European Union

value can be determined based on the information provided in a national database with regard to the customs value of goods with the same origin and that, although not similar within the meaning of Article 142(1)(d) of the Implementing Regulation,<sup>4</sup> are ascribed to the same TARIC code.

### Decision of the CJEU

As a general rule, the transaction value is used to determine the customs value of imported goods. According to Article 29(1)(d) of the Community Customs Code (CCC), the transaction value of the goods cannot be used for determining the customs value where two cumulative conditions have been met:

1. The buyer and seller are related.
2. The transaction value is not acceptable for the purposes of determining the customs value.

In accordance with Article 143(1)(b), (e) and (f) of the implementing regulation, persons may be regarded as being related if they are legally recognized partners in business or when one of them directly or indirectly controls the other or both are directly or indirectly controlled by a third person.

The CJEU ruled that Article 29(1)(d) of the CCC and Article 143(1)(b), (e) and (f) of the implementing regulation should be interpreted as meaning that the buyer and the seller may not be deemed to be related, in a situation in which no documents exist to

prove such a relationship, but the buyer and seller may be deemed to be related if, substantiated by objective elements, it can be demonstrated that one of the parties is de facto in control of the other or both are controlled by a third party.

With regard to the determination of the customs value, the general rule should be followed. First, the customs value must be determined on the basis of the transaction value (Article 29 of the CCC). If the transaction value method cannot be applied, the alternative methods in Article 30 of the CCC can be applied in hierarchical order. If the customs value still cannot be determined according to these methods, Article 31 of the CCC allows the tax authorities to apply the valuation methods set out in Articles 29 and 30 of the CCC with a certain degree of flexibility. The means that are chosen should be based on the available data, and they need to be reasonable and in accordance with the relevant legal framework.

Baltic Master did not provide sufficiently accurate or reliable information regarding the customs value of the imported goods. Therefore, the customs authorities determined the customs value by using the national database relating to goods that are declared by another importer, using the same TARIC code and originating from the same manufacturer. The CJEU confirmed that Article 31(1) of the CCC must be interpreted as not prohibiting the customs authorities from using the national databases containing the customs value of goods that have the same origin and that, although not similar within the meaning of Article 142(1)(d) of the Implementing Regulation, are ascribed under the same TARIC code.

### Fawkes

#### Background

In 2012, Fawkes imported textile goods originating in China into the European Union (EU). The Hungarian customs authorities considered the declared customs value to be significantly low and were of the opinion that an alternative valuation method should be applied to determine the customs value. The customs value was then determined in accordance with the transaction value of similar goods sold for export to the EU by using information from a national database covering a period of 90 days in total (45 days prior and 45 days after the customs clearance) without taking into account the other customs clearances granted to Fawkes.

In this respect, Fawkes claimed that the Hungarian customs authorities should have consulted the databases of various EU services – such as the Directorate-General for Taxation and Customs Union (DG TAXUD) of the European Commission, the European Anti-Fraud Office (OLAF) and Eurostat, the Statistical Office of the EU – to determine the customs value. Fawkes also claimed that the transaction values of its other imports into Hungary and other EU Member States have not been challenged by the customs authorities and should have been taken into account. Additionally, the period taken into account for determining the customs value should have been longer than 90 days.

<sup>4</sup> Commission Regulation (EEC) No 2454/93 of 2 July 1993 established provisions for the implementation of Regulation No 913/92, OJ L 253, 11.10.1993

During the appeal process, the Kúria (i.e., the Supreme Court of Hungary) asked for a preliminary ruling and brought several questions before the CJEU. In essence, the questions were whose database should be taken into account for determining the customs value, whether the values of other transactions from Fawkes should have been taken into account and whether the 90 days for determining the customs value should be extended.

### Decision of the CJEU

Based on precedent court decisions, customs authorities are required to consult all the information sources and databases that are available to them for determining the customs value. In accordance with this obligation, the customs authorities are required to use the national database that contains the necessary information to apply Article 30(2) (a) and (b) of the CCC. The CJEU ruled that these articles should be interpreted as meaning that for the determination of the customs value, the customs authorities of a Member State may confine themselves to using information contained in the national database that it compiles and manages. Said customs authorities should only request access to the information held by the customs authorities of other Member States or by the EU services and institutions if the information is not sufficient for determining the customs value, in order to obtain additional data for the determination of the customs value.

The CJEU also ruled that a Member State, when determining the customs value, does not have to take into account the transaction values relating to other undisputed imports of the applicant provided these are retroactively disputed by the customs authorities. Also, undisputed imports of the applicant in other Member States do not have to be taken into account. The customs authorities of one Member State are, after all, not in a position to influence the choices of the customs authorities from other Member States. The customs authorities should, however, indicate in such cases why the undisputed imports cannot be used as the basis to determine the customs value under the transaction value of identical or similar goods.

Additionally, with regard to the period that covers the use of the data, the CJEU noted that if the customs authorities conclude that the export transactions of goods that are identical or similar to the goods being valued over that period enable the customs authorities to determine the customs value of those goods according to the transaction value of identical or similar goods, the authorities, in principle, cannot be required to extend the cover period of their inquiry.

### Action for businesses

The Union Customs Code (UCC) replaced the CCC on 1 May 2016. Nevertheless, the relevant provisions of the CCC mentioned in these two court cases are to a large extent similar to the provisions under the UCC.

The Baltic Master and Fawkes cases are the result of a new trend whereby the EU customs authorities use statistical values to detect undervaluation and the use of statistical data to determine the customs value in accordance with the alternative valuation methods. However, these cases also make clear that the customs authorities need to indicate why they did not dispute the customs value of previously imported identical or similar goods.

In light of these court cases, businesses should:

- ▶ Review their existing customs valuation policy to determine the impact of these court cases.
- ▶ Assess whether sufficient information has been provided to support the declared customs value.
- ▶ Obtain confirmation from the customs authorities on the correct customs valuation approach to avoid a correction and fine after inspection. ■

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# EU: New version of Compendium on Customs Valuation released



A new version of the Compendium on Customs Valuation (Compendium) was released in July 2022. The Compendium provides Member States and economic operators in the European Union (EU) with non-binding guidance on the provisions related to customs valuation by means of interpretative notes on customs valuation, commentaries and conclusions of the Customs Code Committee Valuation Section and the Customs Expert Group Valuation Section (CEG VAL), and summaries of judgments of the Court of Justice of the European Union (CJEU) on customs valuation matters. Periodically, the EU Commission publishes a revised version of the Compendium.

Key amendments to the 2022 edition of the Compendium include:

- ▶ The addition of Commentary No. 17: Apportionment of license fees under Article 136(3) of the UCC Implementing Act
- ▶ The addition of Commentary No. 18: Valuation of harvest seed; determination of the value of assists under Article 71(1)(b)(i) of the UCC\*
- ▶ The addition of the summary of Case C-599/2020 (Baltic Master UAB v. Muitinės departamentas prie Lietuvos Respublikos finansų ministerijos)<sup>1</sup>
- ▶ The addition of the summary of Case C-187/2021 (Fawkes Kft. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága)<sup>2</sup>

<sup>1</sup> This case is discussed in detail in our article "EU: CJEU rules on use of statistical data for determination of customs value" in this publication, [page 35](#).

<sup>2</sup> Ibid.

### Commentary No. 17: Apportionment of license fees under Article 136(3) of the UCC Implementing Act

In this commentary, the CEG VAL provides guidance on the definition of “appropriate adjustment,” as meant in Article 136(3) of the Union Customs Code Implementing Act (UCC IA). As there is not a legal definition of the concept of appropriate adjustment, the CEG VAL considers three formulas in Commentary No. 17 as an example of appropriate adjustment. The CEG VAL provides the following dataset for these examples:

Data used for the calculation purposes			
	Year 1	Year 2	Year 3
<b>Price paid for the imported goods</b>	450.000	540.000	725.000
<b>Price/cost of other components plus manufacturing cost after importation</b>	150.000	180.000	175.000
<b>Total production costs of the finished products</b>	600.000	720.000	900.000
<b>Total sales of the finished products</b>	1.000.000	1.200.000	1.500.000
<b>License fees paid (5% of the total sales of the finished product)</b>	50.000	60.000	75.000
<b>Total sales margin of Company A related to the finished product</b>	400.000	480.000	600.000
	(1.000.000–600.000)	(1.200.000–720.000)	(1.500.000–900.000)
<b>Sales margin of Company A related to the imported goods</b>	300.000	360.000	483.333
	[400.000* (450.000/600.000)]	[480.000* (540.000/720.000)]	[600.000* (725.000/900.000)]

Based on this dataset, the CEG VAL considers the use of three formulas that all result in a different outcome.

## Formula 1

$$\frac{\text{Price paid or payable}}{\text{Total production costs of finished goods}} \times \% \text{ royalty rate} = \text{dutiabale royalty amount}$$

Year 1		Year 2		Year 3	
$(450,000/600,000) \times 50,000$	<b>37,500</b>	$(540,000/720,000) \times 60,000$	<b>45,000</b>	$(715,000/900,000) \times 75,000$	<b>60,417</b>

## Formula 2

$$\frac{(\text{Price paid or payable sales margin Company A})}{\text{Total sales of finished goods}} \times \% \text{ royalty rate} = \text{dutiabale royalty amount}$$

Year 1		Year 2		Year 3	
$((450,000+400,000)/1,000,000) \times 50,000$	<b>42,500</b>	$((540,000+480,000)/1,200,000) \times 60,000$	<b>51,000</b>	$((725,000+600,000)/1,500,000) \times 75,000$	<b>66,250</b>

## Formula 3

$$\frac{\text{Price paid or payable}}{\text{Total sales of finished goods}} \times \% \text{ royalty rate} = \text{dutiabale royalty amount}$$

Year 1		Year 2		Year 3	
$(450,000/1,000,000) \times 50,000$	<b>22,500</b>	$(540,000/1,200,000) \times 60,000$	<b>27,000</b>	$(725,000/1,500,000) \times 75,000$	<b>36,250</b>

The CEG VAL concludes that the first formula should be used for making an appropriate adjustment for the following reasons:

- ▶ The formula is based on two concepts that are directly comparable, being the price paid for the imported goods (excluding the license fees) and the total production costs.
- ▶ The appropriate amount of license fees to be included in the customs value should be based on the price paid for the goods and the total productions costs, as these are closely related to the imported goods and the imported goods were used in the production phase. It is considered irrelevant in this regard that the license fees are paid as a certain percentage of the total sales of the finished products.
- ▶ The formula is considered to be easily applicable (compared to the other example formulas).

Taking the above into account, the essential elements of the appropriate adjustment are met if the adjustment is based on objective and quantifiable data, which is usually accounting data, that is compliant with the generally accepted accounting principles as defined in Article 1(20) of the UCC Delegated Act.



### **Commentary No. 18: Valuation of harvest seed. Determination of the value of assists under article 71(1)(b)(i) of the UCC**

In this commentary, the CEG VAL provides guidance on the valuation of harvest seed. In the case at hand, a seed supplier imports harvest seed from a third country. The harvest seed is produced by a seed grower company in a third country to which the raw material, basic seed, is provided free of charge by the importing seed supplier.

To determine what customs valuation method to apply in the case of the harvest seed, the CEG VAL considers the concept of sale as defined by the Technical Committee on Customs Valuation of the World Customs Organization (WCO TCCV)<sup>3</sup> and reflected in the Christodoulou case before the CJEU.<sup>4</sup> In that regard, the CEG VAL holds that the production contract concluded between the importer and the seed grower company may be considered a sales contract. This means that the customs value of the imported harvest seed shall be established under the transaction value method as defined in Article 70 of the UCC, taking into consideration the price adjustments established in Article 71 of the UCC.

In determining what provision of Article 71 of the UCC applies in this case, the CEG VAL referenced the *Baywa AG v. Hauptzollamt Weiden* case,<sup>5</sup> in which the court ruled that basic seed provided free of charge should be categorized under Article 71(1)(b)(i) of the UCC, which covers “materials, components, parts and similar items incorporated into the imported goods.” Assists categorized in the subparagraphs of this provision need to be added to the customs value regardless of whether they are produced in the European Union.

To establish the value of the assist, the CEG VAL referenced Commentary No. 18.1 of the WCO TCCV.<sup>6</sup> This commentary indicates that if design or research and development (R&D) work has been undertaken in the European Union, even if for basic seed, the value of this work should be included as part of the cost of acquisition or of production of the basic seed. According to the CEG VAL, this is also supported by the fact that in another case, the CJEU ruled that Article 71(1)(b)(i) of the UCC cannot be interpreted as excluding intangible assets.<sup>7</sup> The CEG VAL argues

<sup>3</sup> Technical Committee on Customs Valuation, 2 October 1981, Advisory Opinion 1.1 – The concept of sale in the agreement.

<sup>4</sup> Judgment of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, paragraph 60.

<sup>5</sup> Judgment of 7 March 1991, *Baywa v. Hauptzollamt Weiden*, C-116/89, EU:C:1991:104, paragraph 4.

<sup>6</sup> Technical Committee on Customs Valuation, 23 October 1992, Advisory Opinion 18.1 – Relationship between Article 8.1(b)(ii) and (b)(iv).

<sup>7</sup> Judgment of 10 September 2020, *BMW Bayerische Motorenwerke AG*, C-509/19, EU:C:2020:694, paragraph 19.



that in the case in hand, the value of the product-related R&D used to produce the basic seed in the European Union should therefore be reflected in the value of the assist and, consequently, in the value of the imported harvest seed.

Based on this examination, the CEG VAL concludes that the customs value should be based on the transaction value method existing out of the following elements:

a) The cost of the multiplication of basic seed to obtain harvest seed undertaken outside the customs territory of the European Union (the

costs are reflected in the invoice issued by the seed grower to the seed supplier)

- b) The value of the basic seed under Article 71(1)(b)(i) of the UCC (comprising product-related R&D; license fees; fees for the multiplication of the pre-basic seed and other costs directly linked to the production of the basic seed in the customs territory of the European Union)
- c) The cost of transportation and insurance of the harvest seed, as well as loading and handling charges associated with its transportation up to

the place where it was brought into the customs territory of the Union (Article 71(1)(e) of the UCC)

### Actions for businesses

It is increasingly important for businesses to assess their customs valuation position, especially in case of separate payments for license fees and in cases where they use formula-based customs values under the transaction value method. Businesses should:

- ▶ Map and visualize the supply chain of companies, including the goods, invoice/purchase order and royalty flows.
- ▶ Assess existing or new contracts that will govern the legal relationship between the seller, the buyer and – if the seller is not the license holder – the license holder.
- ▶ Determine whether royalties and license fees fall within the concept of royalties and license fees for customs valuation purposes and whether they should be added (in part) to the customs value of the goods imported into the EU. ■



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# Germany: Hamamatsu – the journey nears its end

**In the week of 26 September 2022 the Federal Fiscal Court issued its ruling in the Hamamatsu case. This development has not been reflected in this article, but will be covered in the next edition of *TradeWatch*.**

In December 2017, customs experts around the globe (but predominantly in Europe) were surprised by the decision in the Hamamatsu case,<sup>1</sup> which dealt with the long-standing question of downward transfer pricing (TP) adjustments and the corresponding potential for a duty refund. While a refund was denied in this case, the Court of Justice of the European Union (CJEU) concluded that a preliminary price paid between connected parties that is subject to a subsequent lump-sum correction cannot constitute a transaction value for customs purposes.

Almost five years later, following a decision from the Fiscal Court in Munich<sup>2</sup> (which derailed the refund ambitions of the Hamamatsu company) and an escalation of the case to the Federal Fiscal Court in Germany, an oral hearing took place at the Federal Fiscal Court in Munich in May 2022.

Below are several insights on the latest hearing, the likely consequences of the decision and what it may mean for other open cases.

## Case background<sup>3</sup>

Hamamatsu Germany (H/DE), a subsidiary of Hamamatsu Japan (H/JP), receives goods directly from H/JP and distributes them in Germany. In 2009, H/JP and H/DE concluded an advance pricing agreement (APA) with their respective tax authorities for the period from October 2006 to September 2010.

Transfer prices were set preliminarily according to the APA and were adjusted at the end of the transfer pricing period. At the end of the year, H/DE's profit level was below the target range for the relevant period. As a result, H/DE received a lump-sum credit note from H/JP. H/DE later lodged a refund application to the customs authorities, claiming a refund of overpaid customs duties based on the average duty rate of all shipments taken together (i.e., no correction was assigned to the respective single transactions that took place).

The local customs authority in Munich rejected the wholesale correction of the total price, as the adjustment amount was not segregated on a product level and by import transactions. It also argued, among other things, that the mechanism for pricing and subsequent adjustments was not agreed upon in detail in advance. Further, the customs authority stated that refunds would only be possible if, prior to importation, the final total price was precisely defined

<sup>1</sup> CJEU Case C-529/16.

<sup>2</sup> FG München 15 November 2018 (14 K 2028/18).

<sup>3</sup> "CJEU issues ruling on determining transaction value for customs valuation," *EY website*, 19 January 2018. [Find it here](#)





by a formula and clearly related to the imports. In addition, the authority noted that Article 29 of the Community Customs Code (CCC) also points to the actual price paid (i.e., the transaction value method). In response, H/DE argued that it was basing its calculations on a so-called average-duty-rate analysis that, for purposes of external comparison, assumed that all goods imported would achieve the same return on sales.

H/DE subsequently appealed this decision. After the appeal proceedings, legal action at Munich Fiscal Court was lodged. That court, in turn, referred the following questions to the CJEU in a preliminary ruling:

- ▶ Can an agreed transfer price, which is composed of an amount initially invoiced and declared and a lump-sum adjustment after the end of the accounting period, be taken as the customs value using an apportionment formula, irrespective of whether a subsequent debit or credit is made to the party concerned at the end of the accounting period?
- ▶ If so, can the customs value be reviewed or determined using simplified approaches if the effects of subsequent transfer pricing adjustments (both upward and downward) are to be recognized?

### The CJEU decision

The CJEU ruled that the provisions of Articles 28 to 31 of the CCC (which are, in essence, reflected in and replaced by Articles 70 to 74 of the Union Customs Code (UCC) as of 1 May 2016) are to be interpreted

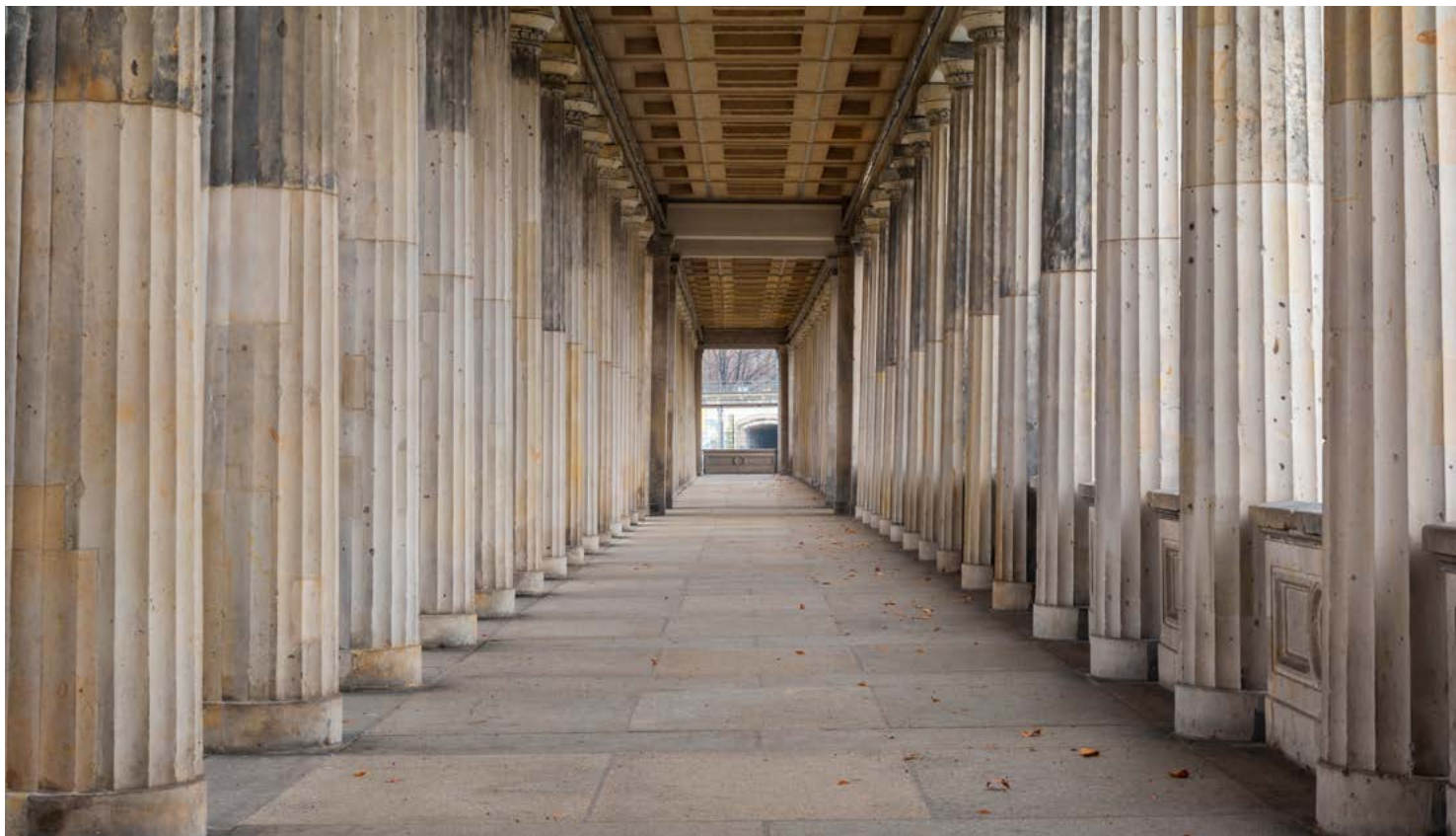
as not allowing the customs value to be based on an agreed transaction value that is composed partly of an amount initially invoiced and declared and partly of an adjustment after the end of the accounting period.

The CJEU further stated in its decision that the CCC does not impose an obligation on the importing company to adjust a transaction value, regardless of whether it was subsequently adjusted. The CJEU added that the CCC does not contain any provision enabling customs authorities to safeguard against the risk that companies only apply for downward adjustments.

Based on these arguments, the CJEU concluded that a retrospective adjustment of the transaction value, such as in the case at issue in the main proceedings, is not possible.

### Subsequent decision of the courts in Munich

In 2018, the Munich Fiscal Court interpreted the CJEU ruling as indicating that the main customs office, the Hauptzollamt, had correctly determined the customs value on the basis of the invoice prices declared during the year. Consequently,



the refund application was rejected. The Fiscal Court in Munich also explicitly criticized the CJEU's judgment of November 2018. In its opinion, the CJEU's judgment only reproduces settled case law with purely factual statements, leaving fundamental questions unanswered.

At the end of 2018, the Hamamatsu company decided to escalate the case to the Federal Fiscal Court in Munich. The final procedural step – an oral hearing – took place in May 2022.

### Likely outcome

This article was drafted after the oral hearing but before the pronouncement of the court's highly anticipated verdict.

Based on the discussions at that time and the reaction of the judge of the German Federal Fiscal Court during the oral hearing, the refund request likely will be refused. That means that although the customs value can be based on an initial transfer price, a downward TP adjustment may not be taken into account in the case at hand. The ruling and the arguments have not yet been made public. However, the judge indicated during the oral hearing that the verdict will not address the treatment of upward adjustments. Nonetheless, declarants who face upward adjustments should stay tuned to see whether the judgment contains any wording that supports importers in not taking into account any upward pricing adjustments for customs valuation purposes.

One important argument for not taking upward price adjustments into account in determining the final customs value could be made with reference to Article 85(1) of the UCC, which states that "the amount of import duties shall be determined on the basis of the rules for calculation of duty, which were applicable to the goods concerned at the time at which the customs debt in respect of them was incurred." By default, transfer pricing adjustments are made after the customs debt occurred, so this argument may be successful – although a court decision would be necessary to have a definitive answer. In that respect, the judge indicated during the verdict that he anticipates a future court case about the impact of upward transfer pricing adjustments on the final determination of customs values. As there are court cases pending on this matter in various EU Member States, the impact of transfer pricing adjustments on the final determination of customs values likely will continue to attract attention in the coming years.

### Actions for business

Importers who are in a potential duty refund position as a result of downward pricing adjustments should not write off their claims. The Hamamatsu case was fact-specific, in particular because the transfer pricing adjustment was not made at a transactional level. As similar cases are pending at various local courts in Europe, legal protection in refund cases should still be claimed.

Importers who have upward price adjustments should consider that customs authorities are likely to uphold their view that these adjustments are dutiable, since they assume that the relationship has influenced the price. However, even in the case of a retroactive declaration or a self-disclosure resulting in an additional customs assessment following retroactive adjustments, businesses could appeal against the assessment and seek legal advice on the matter, as the expected verdict in the Hamamatsu case may provide some strong arguments in their favor. And even if that does not prove to be the case on this occasion, it appears to be more likely than not that any case related to the treatment of upward adjustments will have to be decided by a court.

Because of ongoing developments around the impact of transfer price adjustment on the final determination of customs values, this issue affects a wide range of businesses that import into the EU. Businesses should consider carefully assessing their customs values, particularly if they are based on intercompany prices. Although arguments may be made against taking transfer pricing adjustments into account for determining the final customs values, businesses should consider working with their local customs authorities before importation to have legal clarity about the treatment of transfer pricing adjustments and to limit the risk of incurring additional costs and interest. ■

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# Norway: Common errors when importing and exporting goods

When importing and exporting goods to and from Norway, companies are making potentially costly mistakes that can be avoided. In some cases, issues arise from a new, stricter interpretation of the law by the Norwegian authorities. Other errors may come from an importer or exporter not being aware of the correct procedures. But all of them can have major financial consequences. Being aware of these common pitfalls can help companies engaging in cross-border trading to avoid potentially expensive errors.

## Common errors when importing and exporting goods

### Import:

- ▶ Incorrect customs value for intragroup purchases of goods and services
- ▶ Wrong customs value used in chain sales
- ▶ Wrong company is acting as the importer of record
- ▶ Failure to calculate value-added tax (VAT) when selling goods stored in customs warehouses

### Export:

- ▶ Insufficient proof of origin
- ▶ Lack of documentation for export sales
- ▶ Incorrect understanding of when export sales exist



## Imports

### Intragroup purchases of goods and services

When importing goods into Norway from abroad, customs duties and VAT must be calculated on the basis of the customs value of the goods. As a general rule, the customs value must be determined on the basis of the transaction value (i.e., the price in a sale for export to a buyer in Norway, adjusted for certain costs as described in the legislation, including shipping costs).

In corporate groups, it is not unusual that subsidiaries in Norway, in addition to buying goods, also buy services from the parent company abroad, usually referred to as management fee services. These services may include, for example, administrative, legal and IT services. With the exception of certain services that must be included in the customs value, according to the legislation (including design and development costs and royalties), management fee services should not be included in the customs value. This presupposes that the parent company's invoicing in this respect represents real services supplied to the subsidiary.



However, we have seen cases where certain elements in invoices named as sales of management fee services are not services but instead the parent company's own costs that should have been included in the price of the sale of goods. This could be, for example, administrative costs linked to the parent company's own inventory management abroad. Such storage costs must be allocated to the parent company's own business, regardless of the fact that they relate to the goods that are later sold to the subsidiary. In such cases, the customs authorities assume that the purchase of services must be considered additional payment for the goods, and the amount charged is to be included in the customs value of the goods at import.

Significant challenges may relate to documentation that supports not including the invoiced services in the customs value. The Norwegian customs agency currently operates strict documentation requirements in this context. These requirements relate both to whether services have actually been supplied and to the volume of services provided in cases where the customs authorities accept that the services are real. In recent years, many subsidiaries have been reassessed for significant amounts in VAT and customs duties, including penalties, because the customs authorities have not accepted the documentation of the services.

In these situations, the parent company often operates much of the same type of business as the subsidiary – namely the purchase of goods for resale. This commonly happens, for example, in the consumer products sector. When the parent company performs services or functions that it partly needs for its own business and partly sells to the subsidiary, the question arises as to what should be allocated to the respective companies. In this context, the customs authorities normally do not accept allocations based on turnover, even if such an allocation is accepted by the tax authorities in connection with tax documentation for transfer pricing purposes.

Norwegian subsidiaries that purchase both goods and services from a parent company or from other group companies abroad should focus on ensuring that all the elements in the management fee invoices represent real services of a kind that should not be included in the customs value. In addition, companies should also focus on whether they are able to prove and document that the services have been received and to what extent.



### Transfer pricing adjustments

Changes in the price of goods and services traded between group companies after the fact is common to ensure the correct internal price is achieved for tax purposes. Such corrections are often regulated in price adjustment clauses included in the sales agreement. The changes can be made several times during the year, but most often the price is adjusted once at the end of the year.

Such price adjustments are important for determining the customs value when importing goods, as the value declared to customs at the time of importation must be adjusted accordingly. As mentioned above, the customs value for the import of goods must, as a general rule, be determined on the basis of the transaction value. Application of this method assumes that the price has been finally determined.

If the price has not been finally determined, for example, as a result of price adjustment clauses for transfer pricing purposes, the conditions for applying the transaction value are not met. In these circumstances, customs value must, in principle, be determined based on alternative customs valuation methods. However, it appears from the legislation that it is possible to apply to the customs authority for a postponement of the final determination of the customs

value. Based on these rules, the customs authorities' practice is that importing companies that buy goods from foreign group companies under price adjustment clauses must apply for a postponement of final customs value determination until the price change has been made. A granted postponement will require that the company corrects all customs declarations during the year covered by the price change. Even if such an application has not been sent, in our experience the Norwegian customs authorities are likely to require that the importer corrects all affected customs declarations.

However, many companies are not aware that the customs value must be corrected in such cases and that they are obliged to apply to the customs authority for a postponement of the final customs value determination for future imports. Such an error can prove costly in the form of duty recalculations and additional penalties if the customs authorities discover this issue during an audit.

### **The customs value for chain sales**

Foreign companies may conduct business with the sale of goods for export to several countries, including to customers in Norway. Many of these companies conduct their business on the Norwegian market without having a place of business in Norway, or they are only established in Norway with a branch. When, for example, a German company with such a setup buys goods from external suppliers (e.g., from China), there are several sales in the sales chain: sales from the external supplier to the German company as well as sales from the German company to the customer in Norway.

The question in this scenario is which of these sales represents the relevant sale in relation to the correct customs value or transaction value when the goods are imported into Norway. In our experience, the customs value in these types of situations is often determined on the basis of incorrect sales in the sales chain.

Norway follows the last-sale principle, which means that the transaction value must be determined on the basis of the price in an export sale to a buyer who is established in Norway. According to the legislation, a foreign company that conducts operations subject to registration in Norway is considered to be also established in Norway for customs value purposes, even without any physical place of business. Both sales in such sales chains are therefore covered by the last-sale principle.

The highest transaction value (i.e., the sale based on the price to Norwegian customers) is undoubtedly acceptable according to the legislation in these circumstances. According to the Customs Act, however, there is an opportunity to use the previous sale in the sales chain when it is also considered an export sale to Norway. If the goods are sent directly to Norway from, for example, a supplier in China, the conditions for using this sale are met. If the goods from the supplier are sent to, for example, the company in Germany for intermediate storage/preparation for onward shipment to Norway, the supplier's sale may possibly still be considered an export sale to Norway (and not just to Germany). According to the customs authorities' guidelines, intermediate storage based on "transport considerations" will not be an obstacle to using the previous sale as the customs value. Whether this condition has been met must, according to practice, be assessed concretely in the individual case.

In recent years, the Norwegian customs authorities have interpreted this requirement strictly – even quite insignificant activities in the warehouse related to the goods have led to the conclusion that the temporary storage is not related to transport considerations (alone). For example, if the shipment from China consists of goods that are meant for further shipments to both Norway and other countries, the splitting of the shipment in the warehouse implies that the customs authorities regard the storage as not being made for transport considerations. Companies have been assessed for significant amounts in VAT and customs duties because Customs has based the recalculation of duties due at import using the customer prices in Norway as the customs value instead of the price from the subcontractor overseas. Penalties of 20% to 30% of the re-assessed customs duties have also been imposed in these cases for applying the wrong customs value basis. This issue has hit businesses operating in the textile industry particularly hard, as many textiles/clothing are subject to customs duties based on value/purchase prices.

### **Wrong company is acting as the importer**

When importing goods into Norway, the person stated as the recipient or customs debtor (importer) in the customs declaration is responsible for reporting and paying import VAT and customs duties if the goods are subject to customs duties. In general, if the importer is registered for VAT in Norway and the imported goods are to be used in the VAT-registered business, the importer will

have the right to deduct the import VAT as input tax.

According to the legislation, in principle, anyone can act as the importer and thereby assume responsibility for the reporting and payment of import duties. However, not everyone has the right to deduct the import VAT. Mistakes in this area can prove costly.

In some cases, an already-VAT-registered group company is being used as an import company, despite the fact that another group company, which does not operate a business subject to VAT registration, has bought the goods from abroad. In other cases, the company having bought the goods has been newly established and the VAT registration is not yet in place. The Tax Appeals Board, which recently had a case to consider, agreed with the tax authority's assessment for the deducted VAT, as well as the imposition of an additional tax of 20%. The imposition of additional tax presupposes, among other things, that the error could have led to tax advantages for the importer. Despite the fact that in this case the importing company had reported and deducted exactly the same tax amount in the VAT statement and could not make a profit from the error, the Tax Appeals Board agreed with the tax office that the error could have led to tax benefits and upheld the penalties.

In other cases, the issue relates to the sale of goods from abroad for export to customers in Norway. Uncertainty in these situations is often linked to whether it is the buyer or the seller who may act as importer with the right to deduct the import VAT when both companies carry out activities subject to VAT in Norway. A common example is where a foreign company sells equipment for installation in Norway to Norwegian customers. In such cases, according to practice, the seller will normally be obliged to register for both the sale of goods and the installation work, with the obligation to collect VAT on the entire delivery. If the parties are unaware that the sale of goods is subject to VAT in Norway, they may agree that the customer should act as importer when the equipment arrives in Norway. The customer will then be charged VAT twice for the same acquisition – once by the seller when invoicing the customer for the supplies and again for the importation. In practice, there is uncertainty as to whether the customer in such cases will have the right to deduct both VAT amounts. If it does not, the additional VAT will be a cost.



### **Sale of goods in bonded warehouses**

Companies that buy goods from abroad may commonly choose to put the goods in a customs warehouse. The use of a customs warehouse means that the goods are not cleared through customs upon importation, but only when they are taken out of the customs warehouse for free circulation in Norway. It is only then that the obligation to report and pay import VAT and any customs duty arises.

Sometimes the owner of goods stored in a customs warehouse chooses to sell them when they are still in the warehouse. However, many companies are unsure how such sales should be handled in terms of VAT, and that often leads to them making mistakes in this regard. Many believe that the sales are not considered as domestic sales since the goods have yet not been customs cleared for importation.

However, the tax authority has, in several statements, said that sales of goods in customs warehouses must be calculated for VAT. These are deemed to be domestic sales in Norway since the customs warehouse is in Norway. There is no legal authority in the legislation to handle such sales differently from other goods that are placed somewhere else in Norway. The consequence is that the VAT on the sale of goods can be collected even before the goods have been processed by customs for importation into Norway. In addition, this means that if the buyer of the goods is acting as the importer or customs debtor at the time of removal from the customs warehouse, the buyer is charged twice for the same purchase – once in the sales invoice from the seller and again as import VAT as a result of customs clearance.



This also raises the question of whether the buyer will have the right to deduct both VAT amounts. Many factors indicate that the answer should be yes to that question; however, the central tax authorities have not taken an explicit position on the question, so this issue is not yet clarified.

### Exports

#### Lack of sufficient proof of origin

Most countries have customs duties on imported goods. By using the free trade agreements that Norway has entered into with a number of countries, the buyer in the importing country of goods exported from Norway will receive lower duties or full duty exemption, so-called preferential customs treatment.

The main conditions for obtaining preferential tariff treatment are that:

- ▶ The goods are actually covered by the product groups for which the free trade agreement in question provides preferential customs treatment.
- ▶ The origin conditions in the protocol have been met.
- ▶ A correct certificate of origin has been issued.

There are several types of proof of origin. The most commonly used are the goods certificate EUR1 and the declaration of origin from the exporter, which is normally added to the sales invoice (invoice declaration). The exporter is responsible for the correct certificate of origin being issued. The certificates must accompany the goods to the country of import.

If the exported item is produced based on raw materials from one or more subsuppliers, it is a prerequisite for the exporter to be able to issue a certificate of origin that the supplier can document the origin of the raw materials. If it concerns domestic suppliers, such documentation must be secured by the exporter obtaining a national supplier declaration from them. The same applies if the exporter has not produced the goods himself.

The national supplier's declaration can be affixed to an invoice, a shipping document, other commercial documents or on separate letterhead. If the declaration is applied to documents other than the invoice, a reference must be given to the relevant delivery or deliveries covered by the declaration, and it must be possible to identify the goods.

Norwegian exporters may forget or may not be familiar with the requirement to issue a national supplier declaration in order to be able to issue a certificate of origin themselves. When the customs authorities in the importing country check proof of origin, it is common for them to ask the Norwegian customs authorities for assistance in confirming the correctness of the issued proof of origin, including whether there are valid national supplier declarations. If it turns out that these have not been prepared or that they are not correct, the customs authorities in the importing country will normally recalculate the customs duties for the importer (i.e., the importer will not enjoy the preferential tariff treatment). This mistake may be very costly for the importer. In addition, if the importer succeeds in getting the additional customs duties refunded by the exporter, the mistake will in the end be very costly for the exporter.

It is therefore important that the exporter in Norway – whether that is a Norwegian or a foreign company – familiarizes themselves thoroughly with the requirements for and the design of national supplier declarations if they use Norwegian subsuppliers for the production of goods to be exported.

#### The VAT exemption for export sales – the documentation requirement

Sales of goods for export abroad are exempt from VAT. The exemption must be documented with the sales invoice, customs declaration for export and attestation for physical export in accordance with the legislation. Based on these rules, for the seller of exported goods to be able to apply the VAT exemption, it must, in addition to the sales invoice, keep a copy (printout) of the customs declaration in which the seller itself is indicated as the exporter. In addition, this copy must be affixed with an attestation as documentation that the goods have in fact been sent abroad. If the transporter that transports the goods out of the country is a Norwegian-registered company, it is the transporter that must affix the attestation. In other cases, including if the exporter itself transports the goods out of the country, the attestation must be affixed by the customs office at the border.

However, often an exit attestation is not affixed to the printout of the customs declaration – often because the exporters and forwarding agents are not familiar with this requirement.

Without an affixed export certificate, the exporter does not meet the tax authority's documentation requirements to be able to apply the VAT exemption. If this is discovered during an accounting audit, the tax authorities will have the authority to post-calculate outgoing VAT as if it were a purely domestic sale. Errors in this area can therefore be very costly. Exporters of goods should establish robust documentation and processes in this area to ensure that the requirement for an exit attestation is met for all their export consignments.

### When is there an export sale?

Sales of goods in Norway must, as a general rule, be treated as ordinary domestic sales, and 25% VAT must be collected by the seller. This rule basically applies even if the buyer of the goods plans to send the goods out of the country shortly after the goods have been delivered in Norway. If, on the other hand, the seller is to export the goods, and meets the formal documentation requirements, the VAT exemption for export sales will normally apply.

From time to time, however, the question arises as to how quickly the goods must be sent out of the country for the VAT exemption to apply. This is most often brought to the fore when foreign buyers are to pick up the goods themselves in Norway, so-called pick-up sales.

According to the tax authorities' guidelines, sales of goods to foreign buyers can be handled as tax-free export sales, even if the buyer collects the goods himself in Norway; that is, even if the goods are legally delivered in Norway. In some cases, the foreign buyer of the goods may agree with the seller that, after the goods have been legally delivered, the latter will store the goods for a while before they are transported out of the country. Alternatively, the buyer may engage someone, after legal delivery, to repair the goods in Norway before export.

In contrast to a number of other countries, there are no specific rules or guidelines in Norway for when the goods must have left the country for the VAT exemption to apply. In practice, it is our understanding that the goods must be sent out of the country "as soon as possible" after the sale has taken place. This must be assessed based on the fact in the individual case. In a binding advance ruling issued by the tax administration, it was accepted that it took a full three months before the goods were transported abroad. The background

was that the goods concerned a large number of building modules that, after delivery, the foreign buyer had to catalog and systematically place in a number of containers with a view to reassembling the modules in his home country. The case was therefore very specialized, and we assume that it would not normally be accepted that several months pass before the goods are shipped out of the country.

Some exporters may not be aware that there may be a risk that the sale of goods will not be accepted as an export sale, if they comply with the buyer's wish that the goods are only to be shipped out of the country after some time. Therefore, where a delay is anticipated, this risk should be evaluated and, where necessary, further guidance sought.

### Summary

The consequences of not reporting imports or exports correctly can be a re-assessment of VAT and customs duties, and incurring penalties and delay interest imposed by the customs and tax authorities. It is possible for companies to correct historical mistakes made during import and export. If companies are proactive in correcting mistakes (i.e., before the tax or customs authorities have notified an inspection), penalties are normally not incurred. Conversely, the longer companies wait to correct these mistakes, the more time and costs are incurred when the correction eventually has to be carried out.

Therefore, we recommend that companies involved in exporting or importing goods familiarize themselves with the legislation and the authorities' guidelines and practices to ensure correct processes are adopted and that any errors are corrected as soon as possible. ■

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# Switzerland: Elimination of import customs duties on industrial goods enters into force 1 January 2024

The Swiss Federal Parliament has adopted the bill to unilaterally abolish import duties on almost all industrial goods and simplify the Swiss customs tariff to reduce costs for consumers and companies. This legislative change will enter into force on 1 January 2024.

## Background

In late 2017, the Swiss Federal Council announced its plan to abolish import duties for industrial products (Harmonized System (HS) chapters 25 to 97), among other policies to tackle high prices in Switzerland.<sup>1</sup>

Based on government calculations, the expected duty deficit of CHF500 million per annum could be compensated through higher tax returns from companies, as the zero tariffs reduce not only costs for pre-materials but also bureaucracy for customs clearance procedures. Furthermore, consumers would benefit from reduced tariffs, with overall savings of approximately CHF350 million per annum.

After extensive debates, the bill to abolish industrial tariffs was eventually accepted by both chambers of the parliament in the final vote on 1 October 2021, and no subsequent referendum was launched. In consideration of the required lead time of involved parties for planning and (technical) implementation, the Federal Council decided that the tariff elimination will enter into force on 1 January 2024. With regard to tariff elimination, the Swiss customs tariff also will be reduced, from 6,172 to 4,592 tariff codes.

## Simplified import procedures and tariff classifications

Other than a few industrially produced agricultural products (such as albumin, dextrin or acid oils from refining as covered in HS chapters 35 and 38), the tariffs would be zero, meaning that all other industrial goods could be imported without the payment of any customs duties. Once in effect, the compliance and import procedures for such products will therefore be less complicated and time-consuming, as special procedures (e.g., temporary importation, inward processing relief) may be redundant. In addition, the ongoing transformation



<sup>1</sup> 'Federal Council adopts measures to tackle high prices in Switzerland', *State Secretariat for Economic Affairs website*. [Find it here](#)



program of the Swiss customs authorities (called DaziT) will also offer additional simplifications in connection with the customs clearance of industrial goods (e.g., simplified declaration of proof of origins). Furthermore, the downsizing of Swiss customs tariff lines will simplify the whole tariff classification of products and ease the change of lines in master data.

### Impact on business

In general, import clearance for companies will likely be less burdensome as tariff classification will be simplified and companies will no longer need proofs of origin to benefit from duty reductions in Switzerland. However, companies that manufacture with pre-materials, or re-sell or process products sourced from other countries, still have to comply with preferential origin-related rules of free trade agreements (FTAs) in case their customers request certain proofs of origin. Thus, preferential proofs of origin are still needed and have to be declared for imported goods to ensure origin compliance. Furthermore, import VAT, import licenses, excise taxes (e.g., vehicle tax, VOC) and the corresponding compliance will remain applicable even if there are no customs tariffs.

Even though tariff classification will be simplified, the tariff codes are still the core item in connection with customs clearance, especially in regard to possible permit requirements, origin calculations and export restrictions. It is therefore essential that the internal master data is updated in advance to prevent any unforeseen events and risks.

### Actions for business

The elimination of almost all customs duties for industrial goods and the adaptation of the Swiss tariff codes will require sound planning by companies. Switzerland-based companies should prepare early to enable compliance and to make use of new opportunities that this change will bring. Specifically, businesses should:

- ▶ Quantify the impact in terms of potential duty savings and compliance
- ▶ Prepare master data (e.g., tariff codes, origin calculation) in advance to be compliant with the new structure
- ▶ Update origin compliance procedures
- ▶ Prepare assessments of third-party providers to ensure accurate declaration of imports
- ▶ Explore new sourcing options and partner countries without existing FTAs to optimize supply chain (e.g., for pre-materials)
- ▶ Assess possible domestic processing for (intermediate) manufacturing due to duty reduction
- ▶ Evaluate current customs procedures for optimization

Besides the decline of customs duties and reduction of bureaucracy and costs, companies should also be aware of possible new developments. The European Union is currently planning to implement so-called green taxes (i.e., taxes levied on plastics or carbon

emissions) to encourage companies to drive more environmental awareness when manufacturing or purchasing certain goods. After the EU announced that a Carbon Border Adjustment Mechanism (CBAM) will be introduced for certain goods, a corresponding legislative proposal was submitted for discussion in the Swiss Parliament. Since the EU CBAM excludes imports from European Free Trade Association (EFTA) countries from its scope, Switzerland has to establish a similar regulation to ensure that EU CBAM requirements are not circumvented when goods are imported via Switzerland (i.e., requirements around carbon leakage).

In light of current developments, there will be cost and compliance issues for businesses in Switzerland with respect to the new Swiss green taxes even though customs duties will be abolished. Businesses could consider repurposing their global trade resources and knowledge base to meet the requirements of Swiss green taxes. ■

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# United Arab Emirates: Key trade agreement plans for 2022

Signing Comprehensive Economic Partnership Agreements (CEPAs) with eight strategic global markets is one of the key initiatives of the Projects of the 50 unveiled by the United Arab Emirates (UAE) government in 2021. Projects of the 50 is the vision and roadmap for the UAE for the next 50 years, aimed at attracting foreign investment and bolstering the UAE economy into the next phase of growth, technology and innovation.

## UAE-India CEPA

The UAE signed its first bilateral trade agreement with India on 18 February 2022 and came into force on 1 May 2022. The UAE-India CEPA provides UAE exporters with tariff elimination or tariff reduction on over 80% of goods exported to India, while India benefits from tariff elimination or reduction on over 97% of tariff lines within a phased period of 10 years.

Key provisions from the UAE-India CEPA:

- ▶ The UAE-India CEPA enforces strict rules of origin on local UAE producers to verify origin to disallow products manufactured in third countries to take advantage of trans-shipping products through the UAE. For most products, 40% local value addition is required, with more stringent requirements and special qualifying rules demarcated for specific products.
- ▶ The Rules of Origin Chapter also provides for Certificates of Origin to be issued retrospectively.
- ▶ The UAE-India CEPA allows for automatic registration and marketing authorization of Indian generic formulations within 90 days for those medicines that are approved by certain developed countries listed in Annex 5A of the CEPA.



- ▶ Products that are trans-shipped through the UAE will not be subject to anti-dumping investigation by India.
- ▶ The UAE-India CEPA includes a chapter focused on harmonization of regulatory standards for digital trade between the two countries. The section covers paperless trading, provision for electronic documents to be accorded the same legal standing as paper documents, protection from unsolicited commercial e-messages, and a framework for electronic transactions and online consumer protection. However, non-application of any of the provisions under the Digital Trade Chapter will not lead to any actions under the CEPA's Dispute Settlement Mechanism.

- ▶ Under the UAE-India CEPA, the UAE has been granted access to government procurement contracts, covering 34 central government entities, for deals worth approximately over USD 25 million. The chapter on government procurement also enables India to apply a preferential procurement policy to protect its micro, small, and medium enterprises (MSMEs). Similarly, Indian industries have access to procurement projects undertaken by 41 federal government entities listed in the UAE's Schedule of Commitments.
- ▶ Pursuant to the UAE-India CEPA, the UAE has granted India access to over 100 service subsectors, including telecommunications, construction, finance, tourism, transportation and health related services.

### UAE-Israel CEPA

The UAE and Israel signed CEPA on 31 May 2022. The UAE-Israel CEPA is set to eliminate or reduce tariffs on over 96% of tariff lines and is set to provide greater market access and attract investment in key industries, such as hospitality, energy, e-commerce, aerospace and environment. The trade deal is also said to support different service sectors, such as construction, finance and distribution services, among others. Renewable energy, agricultural technology and advanced technology are also priority areas for both Israel and the UAE.

Trade between the two countries is poised to expand the use of Fourth Industrial Revolution technologies to strengthen supply chains and to harness the power of digital trade, blockchain, cross-border data flows and data localization by virtue of the CEPA.

According to the UAE Ministry of Economy, bilateral trade between UAE and Israel is expected to grow beyond USD10 billion within five years, adding USD.9 billion to the UAE's GDP.<sup>1</sup>

### UAE-Indonesia CEPA

The UAE signed a trade agreement with Indonesia on 1 July 2022 after launching negotiations in September 2021. The UAE-Indonesia CEPA is set to provide immediate zero-duty free access to over 80% of UAE's exports to Indonesia once the agreement comes into force.

The CEPA is also expected to attract investment in sectors such as energy, logistics, agriculture and infrastructure. The UAE-Indonesia CEPA is also said to include provisions on digital trade and streamlining customs formalities.

Both the UAE-Israel and the UAE-Indonesia CEPAs have yet to come into force.

### Upcoming UAE CEPAs

In addition to the abovementioned CEPAs, the UAE has initiated discussions with Turkey and Kenya.

<sup>1</sup> UAE government website. [Find it here](#)





### UAE-Turkey CEPA

The UAE and Turkey began CEPA negotiations in April 2021. When finalized, the CEPA is expected to double the bilateral trade between the two countries over five years. The UAE-Turkey CEPA will be assessing how trade and investment can be expanded in key areas, such as the aviation, logistics, renewable energy, infrastructure and tourism sectors.

### UAE-Kenya CEPA

On 28 July 2022, the UAE and Kenya announced their intention to start trade negotiations within the next few months. This will be the UAE's first CEPA with an African country. Negotiations are expected to follow over the next few months.

### Gulf Cooperation Council (GCC) trade negotiations

Aside from bilateral trade agreements in negotiation, the UAE is also part of trade negotiations underway in the GCC. The UAE is one of the six GCC Member States along with the Kingdom of Bahrain, Kuwait, Oman, Qatar and the Kingdom of Saudi Arabia.

The GCC is currently negotiating trade agreements with the following countries:

- ▶ The United Kingdom (UK): On 22 June 2022, a joint statement announced the commencement of free trade agreement negotiations between the UK and the GCC, with the first round of negotiations to be conducted in September 2022.

- ▶ South Korea: The GCC and South Korea ended the fifth round of negotiations on 9 June 2022, with plans to formalize a trade deal before the end of the year. Discussions for a free trade deal started in 2007 and resumed this year after being stalled for 13 years, since the last negotiation between the GCC and South Korea in 2009.

There are also talks of the GCC resuming free trade negotiations with India<sup>2</sup> and Pakistan<sup>3</sup> in the near future.

Free trade agreements hold numerous opportunities for businesses to optimize their supply chain and reduce operating costs. Businesses trading in or with the UAE should assess whether any benefits are available or if their current supply chain and manufacturing processes can be restructured to take advantage of the CEPAs. Businesses should also take note of any changes in customs procedures, rules of origin requirements or any other standards that may be brought on by the trade agreements and make necessary adjustments to avoid issues of customs compliance. ■



<sup>2</sup> India times website, 17 December 2021. [Find it here](#)

<sup>3</sup> Zawya website, 31 May 2022. [Find it here](#)

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# EU: Final legislation on CBAM expected soon

The European Union (EU) Carbon Border Adjustment Mechanism (CBAM) will be a novel policy instrument in the field of emissions trading.<sup>1</sup> Based on the processes, data requirements and cost effectiveness of this measure as currently envisaged, it will also be significant from the perspective of customs and supply chain planning.

## The EU Emissions Trading System

The background for the implementation of CBAM is the changes planned in relation to the EU Emissions Trading System (EU-ETS). Put simply, the release of emissions by regulated industries comes with a cost, and the EU manufacturers that operate in emissions-intensive industries need to purchase emission certificates (allowances) to cover their emissions. These allowances are generally auctioned unless a part or full release of these emissions is not priced (depending on the industry sector). Companies receive emission allowances free of charge up to industry emission benchmarks.

Since the EU-ETS is a cap-and-trade system, companies emitting less than the benchmark are in a position to sell their excess allowances on the market, while companies emitting more than the benchmark need to purchase from the market.

One of the key ambitions of the EU Green Deal is to fundamentally revise the EU-ETS and charge a price for all emissions. Key changes of the reform are a progressive path of reduction of free EU-ETS allowances until free allowances are phased out, an extension of the system to additional sectors and an increase in the price of emissions.

## Macroeconomic implications

The extension of EU-ETS is likely to mean that the manufacturing of goods in the EU will become more costly for targeted industry sectors (and all operators down the value chain for goods that use components that attract higher carbon pricing). The concern is that this impact may lead to the economic risk of “carbon leakage.” EU manufacturers may

Sustainability



<sup>1</sup> Related articles on this topic are available in previous editions of *TradeWatch* – “CBAM and its impact on EU cross border imports” from *TradeWatch* Issue 1, 2022, page 61, *EY website* and “EU: Emissions – Europe’s new frontier” from *TradeWatch* Issue 3 2021, page 36, *EY website*.

aim to adapt to the new regulatory situation by relocating their emissions-intensive manufacturing outside the EU in countries that impose no or lower carbon pricing and then simply export the same products to the EU market. Also, high carbon pricing in the EU may cause significant competitive disparities between manufacturers operating in markets that have carbon pricing (such as the EU, United Kingdom (UK)<sup>2</sup>, Switzerland and others) and manufacturers operating in countries with lower or no carbon pricing.

The CBAM aims to create a level playing field for the products covered by the EU-ETS in the EU market. In addition, it will require importers to purchase CBAM certificates for the emissions that have occurred during the manufacturing process for products covered by the new regime. In effect, both locally produced and imported products in the EU market will bear the same level of carbon cost. The EU intends to motivate foreign jurisdictions to implement similar systems of carbon pricing with a simple measure. Businesses will have an opportunity to deduct carbon prices paid in the country of origin (if they are properly certified and evidenced), and the hope is that this will motivate exporting countries to implement carbon prices and keep the funds in their own budgets. The EU will, however, not fill its own budgets with CBAM proceeds. Instead, a financial amount at least equivalent in value to the revenues generated by the sale of CBAM certificates will be provided to support the efforts of the least developed countries to decarbonize their manufacturing sectors.

### EU carbon measures: the legislative process

In recent months, the EU carbon legislative process has overcome its highest hurdles to implementation. In June 2022, after an unsuccessful first attempt, the EU Parliament adopted a package of carbon legislation, including revision of the EU-ETS, the CBAM and the Climate Social Fund with a large majority of votes. In July 2022, the EU Council (which includes the EU Member States) also finalized its position.<sup>3</sup> The EU Parliament and EU Council are now working to achieve a consensus. It is important to note that all relevant parties in the legislative process have now confirmed the intended legal revisions, and the negotiations simply involve the details. The final legislation likely will be published in the third quarter of 2022 to continue the legislative process. In addition, the EU Commission is currently in the process of drafting additional implementing regulations that will supplement the primary legislative acts.

### Products covered by the CBAM

The first proposals for a CBAM regulation provided by the EU Commission included a large range of goods in the categories of iron and steel, cement, fertilizers, aluminum and electric energy. There are discussions about extending the product coverage, either from the introduction of the CBAM or after further evaluation at the end of the transition phase. Industry sectors in the scope of the measure include organic chemicals, base chemicals, plastic polymers, hydrogen and refinery products. In the future, products originating from all the sectors covered by

the EU-ETS may become subject to CBAM to achieve a level playing field with imports of those goods from countries with lower or no carbon pricing.

### Emissions covered by the CBAM

The calculation of CBAM will cover the Scope 1 emissions deriving from the manufacturing process. The issue is still under discussion, but it seems likely that indirect emissions deriving from the electricity used by manufacturers may also be considered for inclusion at some point. The scope of emissions may even be further extended in the future.

### Timelines

The EU Parliament and EU Council have emphasized that the transitional period in which importers will be obliged to report emissions contained in imported products (but with no need to purchase CBAM certificates) will start in 2023.<sup>4</sup>

The final CBAM system may be implemented in 2026 or 2027 based on current discussions at the political level. The CBAM will be slowly phased in over a period of multiple years with a progressive curve. The CBAM phase-in will mirror the changes in the EU-ETS, as EU manufacturers' receiving free allowances is phased out. The application of full CBAM cost may happen between 2032 and 2035. These changes are made in parallel to ensure that

<sup>2</sup> The UK proposals are discussed in our article "What UK carbon leakage mitigation measures mean for business" in this publication, [page 60](#).

<sup>3</sup> "Draft regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism", *Council of the European Union website*, 15 March 2022. [Find it here](#)

<sup>4</sup> "Revision of the EU Emissions Trading System", *European Parliament website*, accessed 28 September 2022. [Find it here](#)



both the EU-ETS and CBAM adhere to the legal principles established in the agreements of the World Trade Organization (WTO).

### Reporting obligations

During the transitional period, companies will have to submit quarterly reports. These reports will provide detail on the level of customs import duties for which emissions have occurred in the manufacture of the goods, the weight of the imported goods, the facility and country of origin for the goods and the carbon cost (if any) paid at origin.

Upon final implementation of the CBAM (expected in 2026 or 2027), an annual declaration will be required, with the importer providing the same data as that provided in the transitional period. In addition, CBAM certificates that the importer has purchased during the prior year for its import of goods will have to be surrendered after the CBAM has been implemented.

### How the CBAM cost occurs

After the CBAM system is up and running (likely in 2026 or 2027), the customs declarants for products covered by the CBAM will need to have previously registered with the CBAM authorities. Registration will only be allowed for companies that have a clean track record, offer guarantees for compliance and provide financial guarantees covering the fiscal risk of CBAM payables. The importers (i.e., the customs declarants) will have to plan and monitor their imports in accordance with the new rules and schedule the timing of purchasing the required CBAM certificates.

### CBAM cost

The price of CBAM certificates will derive from the weekly average auction prices of EU-ETS certificates.

### Impact on businesses

The goals of the EU energy and emission policies are clear, and they reflect the urgent need to reduce carbon emissions and meet overall climate goals. The carbon package aims to transform the EU economy to one of zero emissions by 2050, and some EU Member States have even more ambitious national goals and additional national carbon taxes.

Despite the upcoming negotiations between the EU Parliament and the EU Council (and the changes that may occur), the uncertainty about the EU's future climate and emissions policy has almost ended, providing a solid basis for impact assessment and planning.

Initial measures such as the CBAM reporting period for imported goods will commence soon (likely in 2023). Businesses that may be impacted by these measures need to start analyzing and planning for their impact. Effective measures to reduce and finally fully avoid emissions, through innovation and advances in infrastructure and technology (which will be required all along the supply chain) can many take years from planning to realization in many industry sectors. Therefore, the time for impact assessment, strategy planning and execution of preparatory measures is now. This will help organizations both prepare for new compliance obligations and develop long-term strategic considerations. In addition, the CBAM's impact is

not limited to new data and reporting requirements. For example, there also could be additional costs for businesses in terms of emissions occurring during product manufacture, which can heavily impact on product competitiveness, sourcing, supply chain and investment strategy and corporate value, among other things.

These changes to carbon policy are not limited to the EU. Many jurisdictions around the globe are progressing in the same direction, albeit some at a different pace and with a different approach. In any case, given the importance of the EU economic zone for global trade lanes, the changes occurring in the EU will have an impact across the global sourcing and distribution footprints of many businesses. The EU's new emission policy can also be expected to increase the drive to implement similar measures in other jurisdictions. As such, international businesses should proactively address these changes and prepare to align their business strategies and models accordingly. ■

#### Countdown to the EU Carbon Border Adjustment Mechanism

26 September 2022

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# What UK carbon leakage mitigation measures mean for businesses

Following in the footsteps of the EU<sup>1</sup>, the UK is considering how to respond to the problem of carbon leakage, with a planned public consultation later this year.<sup>2</sup>

## What is carbon leakage?

Carbon leakage is the displacement of economic activities, and associated greenhouse gas (GHG) emissions, from one jurisdiction to another as a result of different levels of carbon pricing and climate regulation across those jurisdictions.

As an example, if a business was to move its emissions footprint away from a jurisdiction with a developed system of carbon pricing (e.g., the EU and its Emissions Trading System (EU-ETS))<sup>3</sup> to one without such cost-driving measures (e.g., Brazil<sup>4</sup>). This could result in goods being imported into the EU without being subject to the carbon pricing measures they would have faced had they been manufactured domestically.

## Current and historic approaches to carbon leakage mitigation

Historically, jurisdictions such as the EU and UK have turned to free allocation<sup>5</sup> within their carbon pricing regimes to reduce the likelihood of businesses displacing their manufacturing as a result of carbon pricing.<sup>6</sup> Free allocation, however, can weaken the effective cost of the carbon price for businesses, thus reducing the incentive to decarbonize for impacted businesses.

In response to this, the EU has turned to a new type of measure – a Carbon Border Adjustment Mechanism (CBAM).<sup>7</sup> This measure will apply a carbon price to certain products being imported into the EU, thus mitigating the risk of carbon leakage. More details about the policy proposals can be found here.



## The UK considers its options

In May 2022, the UK government announced an intention to consult on carbon leakage mitigations, following a recommendation from the UK government Environmental Audit Committee (EAC).<sup>8</sup> This was supported by the annual report<sup>9</sup> of the UK Climate Change Committee which urged the government to take stronger measures to tackle carbon leakage in the UK.

1 The EU Carbon Border Mechanism is discussed in detail in our article “EU: Final legislation on CBAM expected soon” in this publication, [page 57](#).

2 “Update on carbon leakage mitigations,” *UK Parliament website*, 16 May 2022. [Find it here](#)

3 “EU Emissions Trading System (EU ETS),” *EU website*. [Find it here](#)

4 “Carbon pricing in Brazil,” *Organisation for Economic Co-operation and Development website*. [Find it here](#)

5 “Free allocation,” *EU website*. [Find it here](#)

6 “Carbon leakage,” *EU website*. [Find it here](#)

7 “Council agrees on the Carbon Border Adjustment Mechanism (CBAM),” *European Council website*, 15 March 2022. [Find it here](#)

8 “Ministers to consult on implementing CBAM following EAC recommendation,” *UK Parliament website*, 21 June 2022. [Find it here](#)

9 “Progress in reducing emissions: 2022 Report to Parliament,” *UK Parliament website*, June 2022. [Find it here](#)

This follows a consultation earlier this year<sup>10</sup> on changes to the UK Emissions Trading Scheme (UK ETS), which included a review of the role of free allocation policy as a carbon leakage mitigation tool in the UK.

While there is currently political uncertainty in the UK, it remains likely that the carbon leakage mitigation consultation will take place, which provides an opportunity for businesses and the public to engage with the policymaking process.

### Implications of the UK consultation process

The UK government may select a carbon leakage mitigation process that differs from that of the EU CBAM regime. However, it is certainly a possibility – given the UK's previous approach in aligning its carbon pricing mechanisms with the EU – that the UK will look to a policy measure that applies a carbon price to imports in a similar fashion to that of the EU.

As the EU regime will apply both cost and compliance obligations to EU Importers, it is likely that similar impacts would arise for UK importers if a UK regime were implemented.

### Now is the time for businesses to consider the potential impact of UK carbon leakage mitigation measures

By applying the EU CBAM features to their operating models, businesses can evaluate the potential impact of a future UK CBAM, assuming that the principles of such a regime would be similar to the EU proposals.

Considering the economic and operational impact of a future UK CBAM can help the business to:

#### ▶ Engage with the policymaking process

As the UK government seeks to define policy and release a consultation, businesses that have considered the implications of carbon leakage mitigation options available – such as a CBAM – should actively engage with the planned consultation and subsequent policy development. This is an opportunity for businesses to support the development of an effective carbon leakage mitigation regime and raise awareness among policymakers of any particular unintended business impacts of any proposed policies.

#### ▶ Improve long-term and strategic decision-making

Carbon leakage measures may affect the future competitiveness or cost associated with prospective or existing investments. Ensuring that the prospect of a highly significant carbon pricing measure is considered in long-term decision-making will be key to protect the value of investments and the business more widely.

#### ▶ Build an effective response team

Increasingly, governments are using fiscal policy as a key lever to move toward their sustainability goals. This means that in markets across the world, new policy measures, including CBAMs, are being implemented to apply a charge to carbon emissions and other polluting or extractive activities. Despite this, many businesses do not have clear responsibilities assigned for management of these new regimes. Understanding future cost and compliance implications will enable the business to identify the right people to be responsible for these issues and take action accordingly – for example, by upskilling tax and customs teams. ■

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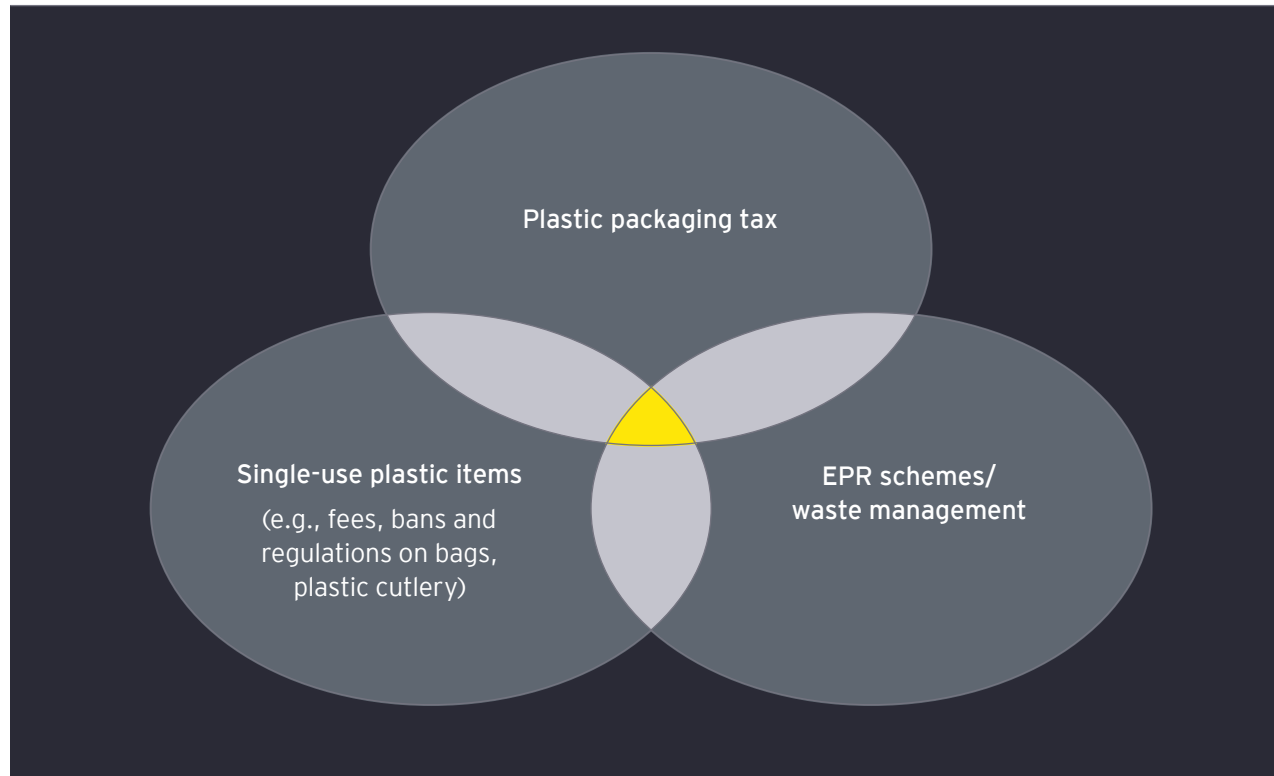
<sup>10</sup> "Developing the UK Emissions Trading Scheme (UK ETS)," *UK government website*, 25 March 2022. [Find it here](#)



# EU: New plastic packaging measures offer businesses an opportunity to innovate

Businesses globally are preparing for a raft of measures aimed at combating the world's plastic pollution problem.

The European Union (EU) Action Plan for key commitments around plastic pollution (also called A European Strategy for Plastics in a Circular



Economy<sup>1)</sup>) is one of several plans to reduce plastic production. It requires all plastic packaging to be recyclable by 2030 and aims to spark improved design, innovative products and new business models to drive sustainability.

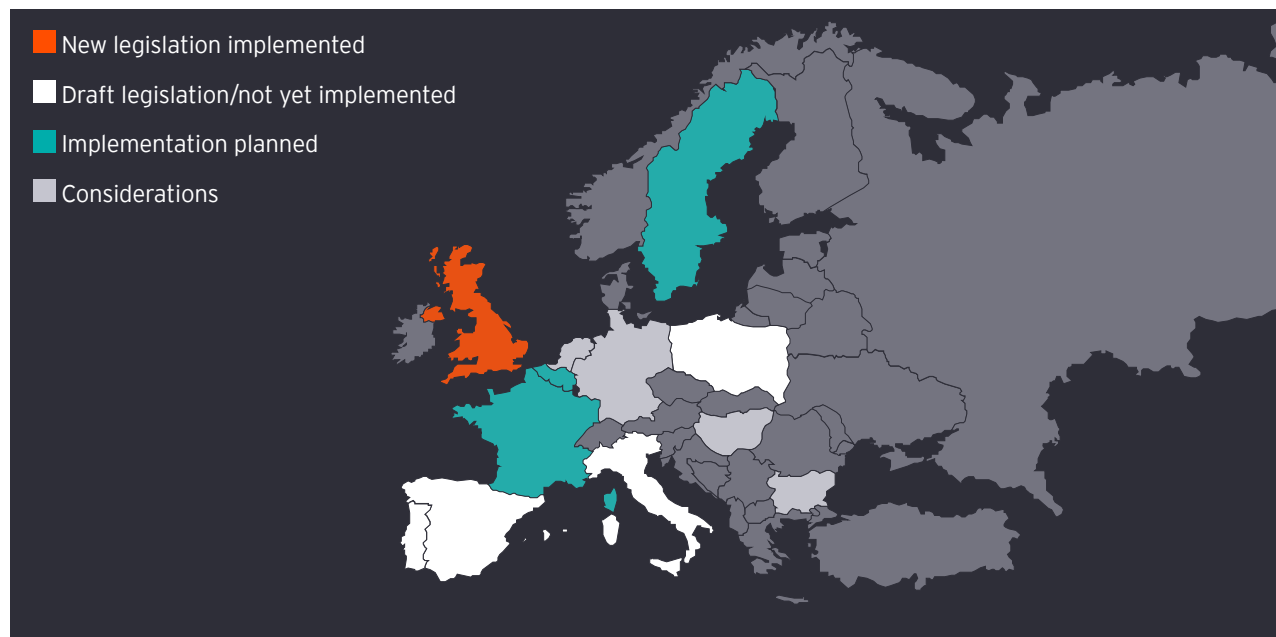
To accelerate this process, the EU implemented the Plastic Levy in 2020 by virtue of which EU Member States mandatorily must pay a contribution of €0.80 calculated on the non-recycled plastic packaging waste being introduced in each respective country. Each Member State can choose how to finance this levy, whether by directly taxing the plastics sector or through other methods of taxation.

However, tax is only one of the several initiatives the European Commission has outlined as part of its strategy to transform the way products are designed, produced, used and recycled. Extended Producer Responsibility (EPR) schemes, as introduced by the Single Use Plastic Directive in 2019, are intended to encourage producers of plastic to improve design.

These measures drive legislative changes across Europe, whereby each Member State decides how to implement these commitments into their local legislation. This lack of harmonization means that businesses must stay up to date on all new legislative developments and all the different rules in the various Member States.

1 'Circular economy action plan', *European Commission website*, 11 March 2020. [Find it here](#)

### European outlook



On one hand, there is an increasing trend for countries to introduce a so-called new generation of plastic packaging taxes, with local legislators independently determining the scope of these new taxes, the criteria around who will be required to pay the taxes, the application and documentary requirements for exemption eligibility, and any required reporting formalities. The first mover was the UK, which introduced its Plastic Packaging Tax on 1 April 2022. Spain and Italy each will also introduce a similar tax on 1 January 2023.

Liability for these taxes will depend on where in the supply chain the tax will be levied. Nevertheless, in most cases, the taxes likely will be charged to the producer of plastic packaging or to the party that has introduced plastics into the local market (either by imports or performs an intra-Community acquisition in the respective country).

### Plastic packaging taxes – an overview

UK	Italy	Spain
<i>Effective as of 1 April 2022</i>	<i>Will be effective in January 2023</i>	<i>Will be effective in January 2023</i>
<b>Scope:</b>		
Plastic packaging that does not contain at least 30% recycled plastic	Non-reusable plastic packaging (only if non-recycled; MACSI)	Non-reusable and non-recycled plastic packaging and semi-finished products as well as plastic caps
<b>Price:</b>		
£200 per ton	€0.45 per kilogram	€0.45 per kilogram
<b>Exemptions:</b>		
Small amounts of plastic and for some medical packaging	Products sent outside Italy, medical use, recycled or compostable plastic	E-commerce activities, products sent outside Spain, medical use, inadequate or destroyed product, and some agricultural use
<b>Threshold:</b>		
10 tons within the last 12 months		

However, there is no consensus on the exact scope, including exemptions. The above overview shows that, depending on the country, there are different interpretations around what constitutes recycled or reusable plastic.

UK legislation prescribes a threshold of 30%, so to the extent that a business can demonstrate that more than 30% of the plastic packaging it uses is recycled, it may rely upon an exemption. By contrast, Spain and Italy have an all-or-nothing approach whereby plastic must be either 100% recycled or



reusable to be eligible for an exemption. A recent FAQ published by the Spanish government provided more than 50 examples of product categories that were within or outside the scope of the new tax.

Further, each country establishes different documentary requirements to prove that the plastics used have been recycled. Although the Recycled Plastics Traceability Certification is a new certification scheme that provides proof of the traceability of recycled plastic material from the source, as well as the specific recycled content of each product, tax authorities have not yet decided whether this would be considered sufficient proof that plastics have been recycled.

Spain has already acknowledged in its last communication that this standard of proof would be acceptable, but the country will, in the first 12 months following the introduction of the tax, allow businesses to prove that plastics have been recycled through a statement signed by the manufacturer. It remains unclear whether this would also create joint and several liability of the latter, as it does in the UK. As Italy only recently announced the entry into force of its new tax, no detailed administrative comments have been released.

To identify, communicate and record the relevant information, businesses will also need to engage and involve numerous stakeholders, both inside the organization and beyond.

Given this background, businesses need to revisit their EPR status by the end of 2024. The proposal amending the Packaging Directive indeed sets new targets to be met by 2025 and 2030 for the share

of packaging waste prepared for reuse and recycling (65% and 75%, respectively), with specific targets for various packaging materials (including plastic, wood, ferrous metal, aluminum, glass, paper and cardboard). Although no 2030 target is proposed for plastic packaging, the European Commission may propose one at a later stage.

France, Germany, Portugal, Poland and others have begun developing strategies to meet these targets. From a business perspective, e-commerce platforms and online marketplaces (both of which are growing) are now seeking explicit confirmation from their retailers that they are duly registered and connected with a Producer Responsibility Organization.

### Challenge or opportunity?

Although it is clear that these changes bring challenges for businesses, at the same time they can be a key driver of innovation. These taxes are designed to drive different behavior and encourage more sustainable packaging. As such, businesses should consider innovating their packaging material strategies (for example, only using recycled material in the near future), which also can help strengthen their brands. ■

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## Italy: New plastic tax applies from 1 January 2023

Plastics are an important material in our economy and daily lives. However, the way plastics are currently designed, produced, used and discarded have a negative impact on the economy and the environment.

In line with the recent European strategy for plastics,<sup>1</sup> to curb plastic waste, several European Union countries have decided to strengthen the role of taxation as a key factor in transitioning toward a more circular economy. In this respect, from 1 January 2023, Italy is expected to introduce a new plastic tax on a wide range of single-use plastic products known as *Manufatti Con Singolo Impiego* (MACSI). In addition to having a significant financial impact throughout the entire business supply chain, this tax will lead to an increased administrative reporting burden for business, in addition to those already in place around managing plastic packaging waste.

In this article, we describe key provisions of this upcoming tax and provide an overview of a number of relevant challenges that businesses may face.

### Legal background

In Italy, the plastic tax was originally introduced by the Budget Law for fiscal year 2020.<sup>2</sup> After being postponed several times,<sup>3</sup> Italy's Budget Law for fiscal year 2022<sup>4</sup> finally set the date for its entry into force on 1 January 2023. Businesses are still waiting for publication of the implementing rules issued by Italian Customs and Revenue Agencies in the Official Gazette.

<sup>1</sup> See Communication from the European Commission, *A European Strategy for Plastics in a Circular Economy*, Brussels, 16 January 2018.

<sup>2</sup> Law n. 160 of 27 December 2019.

<sup>3</sup> Although it has been delayed several times, the plastic tax is finally coming into force with effect from 1 January 2023. Implementing rules, issued by Italian Customs and Revenue Agencies, will be published in the Official Gazette by the end of 2022.

<sup>4</sup> Law n. 234 of 30 December 2021.

### Amount of the tax and products included in the new law

The Italian plastic tax will be charged at a rate of €0.45 per kilogram of virgin plastic included in MACSI items that are composed totally or partially of organic polymers of synthetic origin that provide (or are meant to provide) the function of containment, protection, manipulation or delivery of goods or foodstuffs, and that are not designed to be used repeatedly.

As such, the tax is intended to apply to a wide range of plastic products, including bottles, bags, food containers, tetra pack containers, packaging, rolls of pluri-ball plastic, caps and similar items that are made even partially, of plastic materials consisting of organic polymers of synthetic origin.

Conversely, the tax is not applicable to MACSI items designed to have a long-lasting use or in specific cases and circumstances. In particular, based on the primary law, the tax is not due on plastic material contained in MACSI items that come from recycling processes, and on MACSI items exported or sold directly by the manufacturer to be consumed in another EU Member State. In addition, the following goods are excluded from the application of the tax:

1. MACSI items that are compostable in accordance with UNI EN 13432:2002
2. Medical devices classified by the Single Commission on Medical Devices, established pursuant to Art. 57 of Law n. 289 of 27 December 2002
3. MACSI items used to contain and protect medicinal preparations

### Taxable persons

Depending on the country where the MACSI items are produced or are shipped from, persons subject to the plastic tax are:

- ▶ For MACSI items manufactured in Italy:
  - ▶ The manufacturer or the person (resident or nonresident) who intends to sell the MACSI, obtained on its behalf in a production plant, to other resident persons.

- ▶ A producer of MACSI who uses MACSI on which plastic tax is due by another person, without adding any further plastics subject to the tax, is not considered to be a manufacturer.
- ▶ For MACSI items shipped from other EU Member States (intra-Community transactions):
  - ▶ The person responsible for the tax could be the purchaser or the seller depending on whether the MACSI is purchased for the purpose of an economic activity.
- ▶ For MACSI items shipped from non-EU countries (imports):
  - ▶ The importer.
  - ▶ Although official clarification is lacking, plastic tax should not be due in cases where special customs regimes (such as customs warehouse, transit and inward processing relief) allow MACSI to be under customs suspension (and thus not in free circulation).

### Taxable event

The relevant tax obligation arises in connection with the production, the importation or the introduction of the goods from the EU, of MACSI. The tax is due at the moment of release into consumption of the single good in the Italian territory, as defined by the law.

### Compliance

Depending on who is assigned as the taxpayer and the supply chain, different requirements may have to be met (e.g., registration, accounting entries, quarterly tax returns, payments, and separate storage).

Non-established entities will have to appoint a tax representative who will be jointly and severally liable for the tax due. The Italian Customs Authorities are in charge of any audit activities for all MACSI items subject to the plastic tax.

For MACSI items coming from non-EU countries, the tax is assessed and collected at the time of customs clearance into Italy.

Where the amount of plastic tax due does not exceed €25, the plastic tax return is not to be submitted and the relevant payment is not due.

Businesses are advised to prepare for the new plastic tax process in a timely manner to avoid penalties, to enable their customers to be compliant and to prevent goods being blocked by the Italian Customs Authorities.

### Penalties

Failure to pay the plastic tax is subject to the application of a penalty ranging from two to five times the unpaid tax, with a minimum penalty of €250. In the event of late payment, an administrative penalty applies, equal to 25% of the tax due, with a minimum penalty of €150. The late filing of the relevant quarterly returns is subject to a penalty ranging from €250 to €2,500.

### Possibility of refund

Depending on the supply chain, plastic tax is not due or can be reimbursed for MACSI items that are transferred for consumption in other EU countries or for export, if certain requirements are met.

For this purpose, businesses must ensure full traceability of all the persons involved in the supply chain and proof of the plastic tax actually paid. A refund is allowed for amounts higher than €10.

### Recommendations to businesses

Italy's plastic tax has been delayed several times, but it is now becoming a concrete reality as it will apply from 1 January 2023. This new tax follows the adoption of similar plastic taxes in the United Kingdom and Spain.

It is fundamental that businesses prepare now and, in doing so, take into account the fact that the new plastic tax is one of the most complex indirect taxes in Italy.

As such, the implications of the new tax will go far beyond the tax or customs function of the business. In preparing for the new obligations, businesses should engage across the enterprise and with the wider supply chain. In particular, economic operators should consider this new tax in their pricing policies and its impact on supply chains and processes. For example, affected businesses, depending on their profile within the supply chains, may want to engage with their suppliers for data or consider setting up robust systems to measure the virgin content of MACSI needed to determine and compute the plastic tax. The impact on customers should also be considered.

For example, wholesalers and distributors may prefer to purchase goods from suppliers that are able to guarantee the full traceability of MACSI items and their correct tax compliance to avoid goods being blocked at the Italian borders or to recover plastic tax already paid on goods that are then consumed outside of Italy.



#### Planning for plastic packaging taxes in Italy and Spain

27 September 2022

Register [here](#) to access the webcast recording.

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Tax Alerts

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## Brazil

- ▶ Brazilian tax authority may use information from transfer pricing study in customs valuations (19.08.2022)

## Canada

- ▶ Canada's luxury tax takes effect 1 September 2022 (23.08.2022)

## Colombia

- ▶ Colombia introduces environmental taxes in Tax Reform Bill (21.09.2022)
- ▶ New Colombian Government submits tax reform bill to congress (17.08.2022)
- ▶ New Colombian Government expected to propose tax reform (04.08.2022)

## Costa Rica

- ▶ OECD's Forum on Harmful Tax Practices concludes that Costa Rican free trade zone regime is not harmful (03.08.2022)

## El Salvador

- ▶ El Salvador enacts tax amnesty program (30.08.2022)
- ▶ Salvadoran Minister of Finance submitted a bill to Congress to establish a tax amnesty program (18.08.2022)

## United States

- ▶ US House clears Inflation Reduction Act for President Biden's signature (15.08.2022)
- ▶ Inflation Reduction Act revised to include excise tax on stock buybacks (08.08.2022)
- ▶ Manchin, Schumer, Biden announce climate, health, tax deal (28.07.2022)
- ▶ House clears \$280 billion 'Chips-Plus' bill for President's signature, 243-187 (28.07.2022)
- ▶ Senate passes \$280 billion 'Chips-Plus' bill, 64-33, aimed at keeping US competitive in microchips, science and research (27.07.2022)



# Asia-Pacific

## China

- ▶ Customs and Tax Authorities in Shenzhen launch collaborative management of transfer pricing related to goods imported from related parties (28.06.2022)
- ▶ China announces masterplan for Hainan free trade port (25.06.2022)

## New Zealand

- ▶ New Zealand proposes various changes to tax rules around the gig and sharing economy, taxation of cross-border employees, dual corporate residency, and more (05.09.2022)



# Europe, Middle East, India and Africa

## East African Community

- ▶ The East African Community updates its Common External Tariff 2022 to align with the World Customs Organization (24.08.2022)

## Egypt

- ▶ Egypt provides relief from delay interest, additional taxes, and duties (02.08.2022)

## Ghana

- ▶ Ghana issues 2022 Mid-year Budget Review Statement (09.08.2022)

## Luxembourg

- ▶ Luxembourg publishes draft tax transparency rules for digital platforms (28.07.2022)

## Portugal

- ▶ Portugal issues clarifications and further details on the contribution on single-use packaging made of plastic or multi-material with plastic in Portugal (19.08.2022)

## South Sudan

- ▶ South Sudan enacts Financial Act 2021/2022 (28.07.2022)

## Spain

- ▶ Spanish Tax Authority issues FAQs regarding new plastic packaging tax (28.09.2022)

## United Arab Emirates

- ▶ UAE Federal Tax Authority publishes Public Clarification on financial guarantee calculation for excise tax designated zones (09.09.2022)
- ▶ Dubai Customs launches Self-Audit Findings service (18.08.2022)

## United Kingdom

- ▶ UK announces new trading schemes to cut tariffs on goods from developing countries (05.09.2022)
- ▶ UK implements new Customs Declaration Service for imports as of 1 October 2022 (15.08.2022)

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