



Americas

Mexico

New transshipment provision provides unique benefit under Mexico - Israel free trade agreement

Most free trade agreements (FTAs) provide that originating goods may lose such status if not directly shipped between the territories of the parties to the agreement. Most FTAs, however, also contain a specific exemption that allows goods to be transshipped through the territory of a non-party and maintain their originating status, as long as the transshipped goods remain under the control or supervision of the customs authorities and do not undergo any operations other than unloading, reloading or those necessary to preserve them in good condition. While this general transshipment provision may make preferential trade logistically possible, it nevertheless poses significant constraints on supply chain strategies.

A new transshipment provision under the Mexico-Israel FTA (Article 3-17) offers a unique benefit not offered in any other Mexican FTA. This provision allows goods that originate in Mexico or Israel to maintain their originating status when transshipped through the territories of Canada, the European Free Trade Association (EFTA: Iceland, Liechtenstein, Norway and Switzerland), the European Union and the United States *without being under the control or supervision of the customs authorities*.

Also, this provision allows the goods to maintain their originating status even if certain operations are performed on the goods in the territory of the non-party. Such operations include, among others:

- ▶ Dilution with water or another substance that does not alter the characteristics of the product
- ▶ Operations to ensure the preservation of products in good condition during transport and storage
- ▶ Removal of dust

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- ▶ Sifting or screening
- ▶ Sorting
- ▶ Classifying
- ▶ Washing
- ▶ Changes to packaging and breaking up and assembly of package for retail sale
- ▶ Affixing marks, labels and other like distinguishing signs

The new transshipment provision aims to mitigate the difficulties of international transportation when utilizing the Mexico-Israel FTA by facilitating and expanding available warehousing and distribution strategies undertaken by Mexican and Israeli operations. As a result, business has more flexibility to implement more efficient and cost-effective supply chain strategies. Importers need only file a "Declaration of operations which do not confer origin" at the time of entry to preserve FTZ benefits.

It is worth noting that when the Mexico-Israel FTA first entered into

force in July 2000, Article 3-17 originally stated that within a year the parties would agree on the conditions and procedures required in order to allow an originating good which is transshipped without customs supervision through the territories of Canada, the EFTA, the European Union and the United States to maintain its originating status. Even though it took the parties almost ten years to agree on the necessary conditions and procedures, this innovative transshipment provision finally entered into force on 17 March 2010.

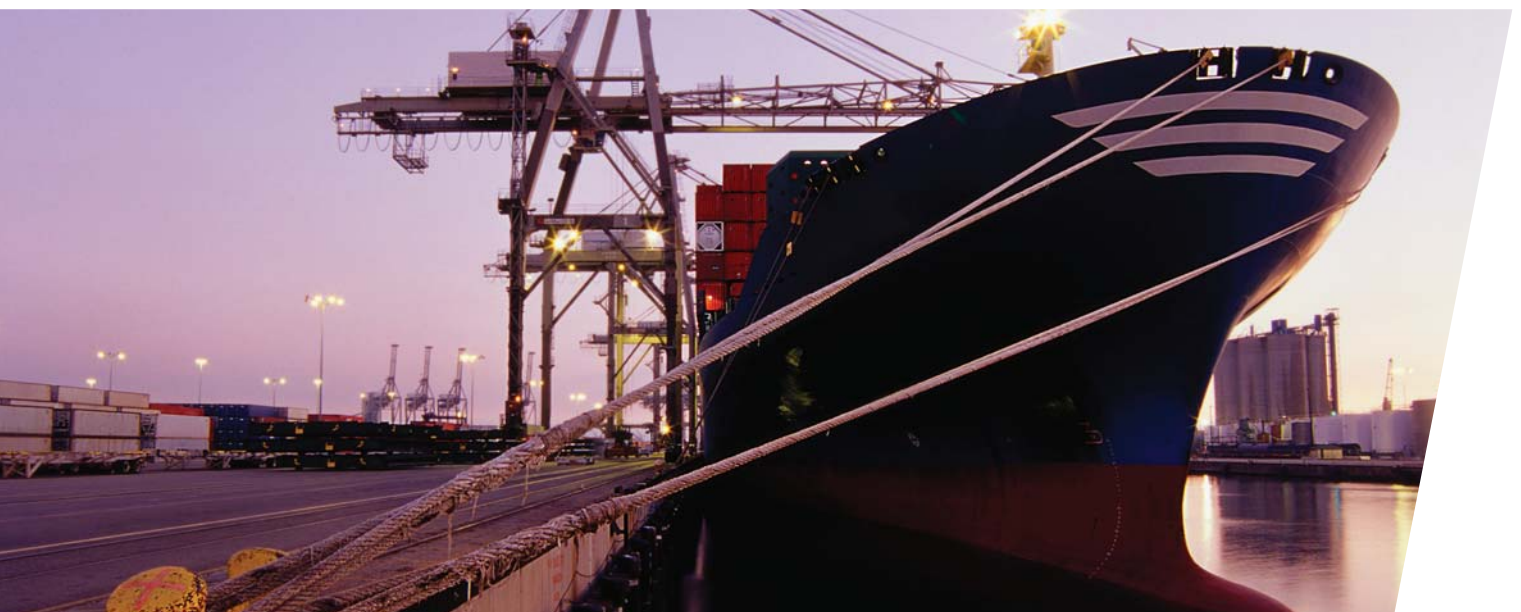
So far, there is no indication that similar rules are under consideration for any the other Mexican FTAs. However, companies currently conducting trade between Israel and Mexico that utilize third-party facilities to warehouse goods in North America or Europe should definitely take advantage of such a unique benefit granting originating status to transshipped goods.

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United States

Foreign Trade Zones Board clarifies production equipment benefit

The Foreign Trade Zones Board issued a memo in May 2010 clarifying its position on the production equipment benefit available to Foreign Trade Zones (FTZs). The benefit was originally created through the 1996 amendment to the FTZ Act, and was designed to promote manufacturing in FTZs by providing duty relief on imported components of machinery and equipment ultimately used in the manufacturing of merchandise in the FTZ. Under the production equipment provision, a zone project is able to realize duty savings and the deferral of duty



payments during the build out of a manufacturing line.

The May 2010 memo notes that the production equipment provision under the FTZ Act, which allows companies in a FTZ to bring in components for the assembly of production equipment and defer duty on those imported components until the production equipment is put into use, is limited to manufacturing operations only. In other words, equipment and machinery components that are imported and assembled for use in the production of manufactured goods under the FTZ authority qualify; warehouse distribution equipment does not qualify.

Further, the memo indicates that companies can take advantage of the production equipment benefit while their manufacturing application is being reviewed by the Board. With manufacturing applications often taking six to eight or more months to be approved, companies would be able to immediately access zone savings related to production equipment during the manufacturing plant build out and machinery testing phase of a project. If the manufacturing application is denied, however, the company will be responsible for the full payment of duties on the imported components.

The Board's position allowing companies to take advantage of the production equipment benefit while a manufacturing application is being reviewed teams quite nicely with the ability to obtain FTZ designation more easily under the new

Alternative Site Framework (ASF) program. The ASF program allows Grantees to quickly "designate" space for use by zone users and would be beneficial in this instance for companies seeking permanent FTZ status for manufacturing operations. Companies can now realize an expedited return on their investment in FTZ operations while they wait for manufacturing approval to be granted.

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Asia Pacific Thailand

Thai Customs Voluntary Audit Program - a rare opportunity to minimize customs liabilities

The Thai Customs Voluntary Audit Program (VAP) is now available until 30 September 2010. VAP is a rare and limited opportunity to minimize customs liabilities.

In Thailand, the customs clearance of goods is based on the principle of self-assessment whereby the importer is responsible for accurately and completely filing customs declaration forms and assessing customs duties and related taxes. In turn, the shipments are cleared with minimal customs intervention. To regulate compliance with the customs laws and regulations, the Thai customs authorities conduct audits, which

can occur many years after the goods are imported/ exported.

The implications of non-compliance identified by the customs authorities can be severe. In addition to the underpaid duty, companies can be assessed penalties up to four times the aggregate value of the goods and duties involved. Further, the customs authorities can go back 10 years to recover the underpaid duty and impose penalties up to 15 years from the date of import. Additionally, companies are subject to underpaid VAT, VAT penalties equivalent to one time the underpaid VAT, and interest on VAT underpayments (1.5% per month, capped) as well as interest on customs duty underpayments (1% per month, uncapped).

Similar to the VAP introduced in 2007, the new VAP provides a limited opportunity for companies that have inadvertently underpaid customs duties and VAT to undertake a self examination and settle any underpayments. The company is then not subject to customs/ VAT penalties and customs duty interest charges. VAP offers greater benefits than the standard voluntary disclosure process, which does not protect companies from the VAT penalties and customs duty interest.

In theory, the Customs Audit Bureau invites companies it believes have compliance issues to participate in the program. In practice, however, it may be possible for a company to proactively request to participate in the program. In both cases, a formal and clear acceptance from

the company is required.

The following circumstances are excluded from VAP:

- ▶ Issues disclosed under a previous VAP
- ▶ Issues relating to smuggling or bad faith (with clear evidence) in relation to duty avoidance
- ▶ Issues relating to import of prohibited/ restricted goods or goods infringing intellectual property rights
- ▶ A company subject to an ongoing post-importation audit/ investigation or prosecution in respect of customs offenses by relevant government authorities (e.g., Department of Special Investigation)

Companies concerned about past non-compliance should consider proactively taking advantage of the VAP benefits. The first step is to undertake a self-review of import/export activities, particularly with respect to verifying the correctness of duty and VAT payments, and assess the potential customs liabilities. Depending on the customs exposure identified, the VAP may be an advantageous strategy - but time is of the essence.

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Europe, Middle East and Africa

Germany

Amended excise legislation in Germany impacts intra-community distance selling

In the European Union, Council Directive 2008/118/EC (16 December 2008), concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, has brought about extensive changes for trade in goods subject to excise taxes. While the main objective of the Council Directive was the implementation of the new computer-based Excise Movement and Control System (see the March 2010 issue of TradeWatch), other areas of excise tax law were also affected, including the rules for distance selling.

Distance selling in Germany

Commercial transactions are referred to as “distance selling” when excisable goods, which are in free circulation in the country of dispatch, are sold from a commercial seller in one Member State to a private individual in another Member State. The vendor is either directly or indirectly responsible for the delivery of the goods. Distance selling includes mail orders as well as transports by couriers and parcel companies.

In essence, the Council Directive does not change the general system of distance selling. In principle, the excise duties must be paid at the time of delivery in the country of

destination and the excise duties must be guaranteed before the goods are dispatched.

In the past, the distance seller vending excisable goods to a private individual in Germany was generally the debtor of the excise duties. Optionally, the distance seller could nominate a tax representative, but this was not mandatory (except in the coffee tax legislation, which is not harmonized). As a consequence, in addition to payment of the excise duties, the distance seller was also responsible for various legal requirements in Germany (e.g., submitting the preliminary report of each shipment to the responsible customs authorities and filing of the relevant excise tax declarations).

New requirements

As of 1 April 2010, a distance seller based in another Member State must appoint a tax representative in Germany in order to sell goods to customers in Germany. The tax representative becomes the debtor with respect to the payment of the excise duties and fulfilment of various formal requirements. However, the distance seller is ultimately liable for any non-compliance.

The new legislation affects the German excise laws for spirits, sparkling wine and intermediate products (e.g., sherry), alcohol, beer, coffee and energy products. The German excise laws for wine, tobacco and electricity do not offer special rules for the legal concept of distance selling from other Member States.

Prior to the initiation of any distance selling to Germany, the distance seller of another Member State must first notify the German customs authorities. Additionally, the nominated tax representative must obtain an authorization from the responsible German customs authorities to act on the distance seller's behalf.

The tax representative performs the following responsibilities on behalf of the distance seller

- ▶ Maintains a receipt book and records of the shipments to Germany
- ▶ Files a report, which provides details decisive for excise tax purposes, to the responsible customs authorities in advance of each shipment
- ▶ Files the appropriate tax declarations for the shipments (simplifications in this context may apply)
- ▶ Accounts for and pays the excise duty due in the name of the distance seller

We emphasize that the distance seller is ultimately liable where the tax representative fails to comply with these requirements, and may be subject to administrative penalties for any non-compliance.

The amendments to the German excise duty legislation pursuant to the Council Directive have changed the way distance selling of excise goods is conducted in Germany. Affected businesses need to understand the new rules and responsibilities, nominate an approved tax representative and

establish procedures to ensure compliance. In this context, compliance with the existing national VAT requirements should also be considered.

Additionally, we note that businesses engaging in intra-community distance selling to other EU countries should check with local rules of those countries, considering that national excise tax laws have undergone amendments pursuant to the Council Directive.

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Russia and Ukraine

Customs authorities of Russia and Ukraine issue same classification decision for magazines with supplements

A few months ago, the Federal Customs Service of Russia and the State Customs Service of Ukraine adopted the same preliminary classification decision for a magazine with a supplement. The result is beneficial for importers of such commodities and also highlights the opportunities for proactively seeking favorable tariff classification decisions in multiple jurisdictions concurrently.

Magazines are often sold with supplements (e.g., CD or DVD; a part for model assembly; a scale model copy; a toy; a sample; etc.) If the magazines and supplements are imported separately into the

territory of Russia and Ukraine, the magazines are assessed duty at 0% in both countries with VAT at 10% (in Russia) and 20% (in Ukraine) while the supplements are assessed duty at 10% in both countries and VAT at 18% (in Russia) and 20% (in Ukraine). After importation, the magazine and supplement would then be packaged together for retail trade and sold in the local market. This scenario produces two primary issues for the importer: (1) duty cost for the imported supplement and (2) tax authorities questioning the VAT refund request (10% for imported magazines and 18% for imported supplements, whereby sale to recover the VAT was for a magazine with supplement (10% VAT)).

Pursuant to the classification decisions of the Russia and Ukraine customs authorities, the magazine imported together with the supplement already attached is properly classified as a magazine (HS 4902 90 10) - duty-free - where certain criteria are met. The decisions are based on the General Rules of Interpretation 1, 3(b) and 6 of the Harmonized Commodity Description and Coding System (as incorporated into the tariff nomenclature of Russia and Ukraine).

According to the Rule of Interpretation 1, goods are classified with regard to the texts of the commodity items and the relevant notes to the sections or groups. In other words, the description and features of a magazine with a supplement should conform to the description of



the commodity item to which the magazine with the supplement was referred.

According to the substance of the Rules of Interpretation 3 (b), mixtures, multi-component articles composed of various materials or made of various components, and commodities which are in the sets for retail trade should be classified by the material or component which is the main feature of the commodity, provided that such a criterion can be applied. The main feature of the set for retail trade, i.e., the magazine with the supplement, is the magazine.

According to Rule of Interpretation 6, in order to classify the magazine with the supplement in more detail, account should be taken of the sub-items and notes, i.e., once the commodity item is determined (for instance, if it is determined that the magazine with the supplement is in the category of magazines, and not books), it is necessary to determine the periodic intervals at which the magazine with the supplement is issued. Thereby, the index number of the commodity will be known.

The main criteria whereby the customs authorities of both countries adopted such a classification decision were the following:

- ▶ The magazine is declared for import together with the supplement under one contract
- ▶ The magazine and the supplement are packed together as a set for retail trade upon importation
- ▶ Each magazine is composed of textual and illustrated materials, of which a certain part of the materials describes the supplement

Hence, the supplement is considered to further illustrate the information set forth in the magazine.

An important argument prompting the customs authorities to adopt the above decisions was the European Commission's adoption of a similar decision, although the matter in question was not magazines with a supplement, but rather books with illustrations and

a supplement. This is a significant point.

Traditionally, countries have applied their own interpretation of the HS System, based strictly on local decisions. In Europe, however, we are finding that customs authorities in some non-EU countries are becoming more open to positions by importers based on technical merit that include decisions by the European Commission as guidance in making tariff classification decisions. In turn, business has more opportunities to consolidate efforts to proactively and concurrently seek a beneficial tariff classification decision in multiple jurisdictions. The result can produce customs duty savings while also establishing more business certainty with respect to product costs.

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United Kingdom

The new UK Bribery Act

The United Kingdom recently passed a new UK Bribery Act (the Act). The Act creates a more effective legal framework for combating bribery, replacing a number of fragmented and complex offenses, many of which had been in place for more than 100 years. The Act poses global risks and obligations for multinational companies that have jurisdictional presence within the UK (whether by carrying on business within the UK, or by having the parent or subsidiary entities incorporated or formed under UK law).

The Act goes significantly further than the provisions of the US Foreign Corrupt Practices Act (FCPA) in two main areas. Firstly, it covers all bribery, whether or not it involves a public official. And secondly, there is no exemption for "facilitation payments."

The new Act signals a fundamental change in the UK's approach to prosecuting corruption and the authorities have already made significant investment in enforcement capabilities. This change in approach is underlined by a growing number of high-profile actions taken against corporations recently.

With the Bribery Act comes an urgent need for each business to re-examine its approach to managing bribery risk and to ask whether its current procedures are adequate.

The provisions of the Act

The Act creates four offenses:

- ▶ Two general offenses covering the offering and receiving of a bribe
- ▶ A separate offense of bribing a foreign public official
- ▶ A new corporate offense of failing to prevent bribery

The offenses under the Act extend to operations outside the UK.

The new corporate offense of failing to prevent bribery is of particular note. Before the Bribery Act there was no such offense. Now, it is a strict liability offense that includes the activities of third parties acting on a business's behalf. The legislation allows for unlimited fines under this offense.

The defense available to corporations is one of having "adequate procedures" in place to prevent bribery, but guidance issued so far as to what procedures would be considered adequate has been high level.

The offenses by individuals will be committed when a person offers a financial or other type of advantage to another person with a view to inducing them to act improperly. These offenses carry a maximum penalty of 10 years imprisonment.

The Bribery Act and the FCPA

The FCPA is likely to be familiar to businesses with links to the United States. This piece of legislation has already led to high-profile cases in which reputations have been severely damaged, fines of billions

of dollars have been levied and jail terms have been handed down for senior executives.

However, the UK Bribery Act goes further in its reach than the FCPA and compliance with the FCPA does not necessarily mean compliance with the Bribery Act. The Bribery Act goes further than the FCPA in the following main respects:

- ▶ It draws no distinction between public sector and private sector bribery, bringing in to its remit business-to-business bribery.
- ▶ There is no exemption for facilitation or 'grease' payments.
- ▶ It introduces a new corporate offense of failing to prevent bribery.

Companies subject to both the Bribery Act and the FCPA need to examine existing procedures for conformance with both laws.

Agents, consultants, distributors, joint ventures, freight forwarders, customs brokers, and other third parties

Of particular note should be a business' exposure as a result of third-party relationships.

Agents, consultants, distributors, joint ventures and new acquisitions create exposures which can be difficult to assess, but these are the areas where the risk can be greatest. Organizations need to look carefully at the due diligence they carry out on third parties who act on their behalf.

The Act provides that the person committing the act need only

be associated with the company and the definition of “associated” includes, essentially, one performing services on behalf of another. The Act specifically acknowledges that this covers employees, agents and subsidiaries. While the Act is presently untested in this regard, it would not be a large logical stretch to extend liability (and resulting obligations) to the activities of customs brokers, freight forwarders and/or visa processors conducting business on behalf of another, particularly given that such entities may be considered “agents” under operative law in the relevant foreign jurisdictions.

Impact on business

Considering the broad reach of the UK Bribery Act, which can apply to non-UK companies that conduct business in the UK as well as situations that occur outside of the UK, all global traders should pay attention to this legislation and consider the impact on their business.

The “failure to prevent” offense is likely to be effective from October 2010. For larger organizations in particular this leaves little time to assess the current state of their anti-bribery and corruption frameworks and implement improvements. The Ministry of Justice has said that it will provide further guidance on what constitutes “adequate procedures,” but businesses should be acting now to prepare. There are non-governmental pre-existing frameworks for assessing the effectiveness of financial reporting

and regulatory compliance internal controls which allow for progress to be made in the absence of specific instructions from Justice.

Guidance so far from the Serious Fraud Office and the GC100 organization of leading General Counsels on adequate procedures sets out the following broad areas for consideration:

Framework

- ▶ Clear statement of anti-corruption culture with responsibility at board level
- ▶ Principles applicable regardless of local laws and culture
- ▶ A compliance function
- ▶ Risk assessment procedures
- ▶ Formalized decision-making
- ▶ Individual accountability

Codes, policies and training

- ▶ A Code of Ethics
- ▶ Policies on: gifts; hospitality; facilitation payments; outside advisors; political contributions and lobbying
- ▶ Training to disseminate anti-corruption culture to all staff at all levels

Controls and monitoring

- ▶ Financial controls to minimize risk
- ▶ Regular checks and auditing in a proportionate manner

Supply chain

- ▶ Commitment to making anti-bribery measures apply to business partners

- ▶ Due diligence over business relationships and projects
- ▶ Reporting and investigation
- ▶ A helpline for the reporting of concerns (whistle blowing)
- ▶ Proper investigation of all allegations
- ▶ Appropriate and consistent disciplinary procedures

Next steps

As a result of the new legislation, organizations urgently need to examine their existing anti-bribery and corruption measures, benchmarked against leading practice and sector norms, and assess what improvements should be made ahead of the corporate offense coming into effect. Particular attention should be paid to current and potential future relationships with third parties.

The global changes in working practices that may be required as a result of this legislation can be difficult and slow to implement. Organizations should be taking action quickly to be prepared.

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South Africa

Reviewing South Africa's new Customs Bills

South Africa is in the process of modernizing the country's outdated customs processes to facilitate trade and implement customs controls better suited

for today's fast-paced global trade environment. An important milestone was reached in October 2009 with the public release of the new Customs Bills, consisting of the Draft Customs Control Bill and Draft Customs Duty Bill together with the Draft Tax Administration Bill. The new Customs Bills aim to replace the Customs and Excise Act 91 of 1964 (the Act).

The South African Revenue Service (SARS) has publicized a variety of noteworthy changes in the new Customs Bills, a few of which we mention below:

- ▶ An emphasis on electronic reporting and declarations in order to speed up processing, reduce errors and enable effective risk assessment.
- ▶ Appropriate provisions to give maximum effect to the principle of self-assessment with the role of the customs authority focused on verification of self-assessment rather than on assessing the amount of tax.
- ▶ Fast-tracking clearance and release procedures in respect of certain categories of persons (accredited) or goods (low-value goods).

Ernst & Young, together with customs specialists from a major law firm and one of the other "Big Four" accounting firms in South Africa, undertook an extensive review of the voluminous Customs Bills on behalf of BUSA (Business Unity South Africa), an organization which represents organized business in South Africa. The mandate was extended to

include our direct involvement in the NEDLAC (National Economic Development and Labor Council) process, which is a vital element of the Parliamentary legislative approval process.

The commentary

Our overall involvement in the review process has provided us with an in-depth knowledge of the draft texts and valuable insight into the views of various stakeholders involved in the process. While overall the draft Customs Bills set forth some welcomed changes for the trade, the review process has brought to light some areas of concern - a few of which we highlight below. We emphasize, however, that the corresponding rules and implementing provisions have not yet been released for public comment. Without them, any commentary cannot be complete.

Increased reporting requirements

Throughout the draft Customs Bills, the levels and frequency of reporting are extensive, and much more so than the current Act requires. Rather than being streamlined, in some cases there seems to be duplication of reporting, which means duplication of efforts for the trade. Such burdensome requirements can increase costs and hamper trade with South Africa without having the desired objective of customs duty compliance.

In numerous instances, the Customs Bills require reporting of certain information in a much shorter

period of time than required under the current Act and in some instances, may not be practically possible to comply to. For example, trains arriving from African neighbor states are not able to provide the advance notice required by the Draft Customs Control Bill as the information is simply not available and the constitution of the train may change at the last stop prior to entering South Africa.

As touted by SARS, the new Customs Bills place an emphasis on electronic reporting and declarations. The Bills, especially with respect to the reporting provisions, are structured and worded in a manner that assumes that South Africa's Customs Modernization Program has reached the advance stages. Specifically, all role-players would need to adopt and implement the necessary electronic submission capabilities by the time the Draft Bills are passed into law. Considering that South Africa currently conducts trade using primarily manual processes, it is questionable as to how such provisions can be implemented and enforced in the short-term. Further, at present, there seems to be no consensus or undertaking by SARS in this regard, and care should be taken that the process for implementing the new Customs Bills is aligned with the Customs Modernization Program.

Similarly, certain provisions assume that SARS will have capacity to process all these reports and submissions, and to do so far quicker and more accurately than

ever before. It appears to have been assumed, by the drafters of these Bills, that the level of skill and technical knowledge will have been elevated from its current level. There has been no undertaking in this regard to increase staff and improve training efforts, so one wonders whether they will be able to perform their new obligations, especially in terms of reporting.

Potential liability for persons with “beneficial” or “material” interest in the goods

The draft Customs Control Bill introduces the concept of joint and several liability for the payment of duty that can be imposed on any person with a “material interest” in the goods, or an importer/exporter of the goods. The definition of an “importer” and “exporter” includes any person with a “beneficial interest” in the goods. These terms are very broad and may well catch innocent parties in its ambit. An example of such an innocent party could be the bank which is financing the transaction.

It is unknown whether the terms will withstand the comments stage and one hopes it will have been further defined and limited in this process. The impact on industry is

vast. With the additional reporting, as well as the concept of joint and several liability, industry could face draconian penal provisions. As a matter of interest, Organized Labor within the NEDLAC structures is even seeking to increase the severity of such penal provisions, by, for example, imposing a prison sentence instead of a fine.

Vague accreditation program

It seems reasonable to assume that the new Customs Bills and the forthcoming rules will rely heavily on compliance by industry through self assessment and a type of “accreditation” program, a concept similar to the European Union’s Authorized Economic Operator program. The accreditation concept is contained in the Bills, but little detail is given, so it is difficult to envisage the benefits of being accredited. Moreover, as stated above, little or no mention is made of the Customs Modernization process (which will obviously entail electronic submission) and this is intricately linked with the accreditation concept.

From Draft Bill into law

While there are a few points of concern, generally, the

draft Customs Bills have been enthusiastically welcomed by the trade. Although the review process has not been without flaws, overall the experience has been a positive one and if this is any indication of the future, we hope that any issues which arise when implementing the legislation will be dealt with in a timely and transparent way. Although there has been no official undertaking in this regard, there are suggestions that the Bills may be passed into law by 1 October 2010. Notably, this is only a few months away, and the corresponding rules still need to be released for comment. Based on our experience commenting on the Draft Bills thus far, and our interaction with SARS as well as participation in the NEDLAC process, this deadline may be achievable- provided there is the right amount of interaction between SARS, stakeholders and their consultants.

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