hunt & hunt lawyers

Customs and Global Trade Update

May 2015

Customs issues for the auto industry

The Australian automotive industry is going through a period of transformation. This coincides with significant ongoing developments in Australia's customs and global trade landscape. These two areas of change are interacting and creating customs opportunities and risks that are unique to importers and exporters of motor vehicles and their parts. In addition, the review into Australia's tax system creates the opportunity for even greater change.

Below we review seven overlapping customs issues currently affecting the auto industry and what traders are doing now in response to those issues:

1. Trusted Trader Program
2. The Government's tax review
3. Classification of vehicle parts
4. Transfer pricing - possible solutions to the customs issues
5. Customs compliance and refund applications
6. Strict approach to the use of tariff concessions
7. Free Trade Agreements – an update on China, Japan and Korea.

1. Trusted Trader Program

What is it?

If its proposed benefits are fully realised, the Trusted Trader Program (TTP) could represent the biggest development in Australian Customs in at least the last ten years. Under the TTP, participants in the supply chain who can demonstrate a high level of customs trade compliance and supply chain security will be granted trade facilitation benefits.

Due to high duty rates and the commercial importance of a globally secure supply chain, auto companies are already world leaders in customs and supply chain compliance. This is an ideal position allowing auto companies to take advantage of the TTP.

What are the benefits?

The benefits are varied and could include:

- Streamlined reporting
- Duty deferral
- Preferential treatment under free trade agreements (FTAs)
- Improved export trade facilitation.

Other proposed benefits (which are more certain at this stage) include reduced compliance activity by Customs, a Customs client service manager and head of queue status in respect of Customs services, such as rulings.

Duty deferral will be a significant benefit for auto importers seeking a cash flow benefit. The size of that benefit will depend on the deferral period and the cost of cash to the business. What may be of greater benefit will be the cost savings and efficiencies achieved through streamlined reporting.

It is hoped that periodic reporting will replace transaction by transaction reporting and that there will be a reduction in import declaration charges. At $152 for every consignment over $10,000, frequent importers would see a significant benefit from the implementation of a single charge for a single periodic entry.

Importantly, Customs is yet to detail what form this streamlined reporting will take and the cost benefits that will be realised. However, it has indicated that these benefits will only be available to those traders that qualify for the highest level of accreditation.

When will it commence?

A pilot for up to four sea freight exporters will commence on 1 July 2015. Over the following 12 months the pilot will expand to include importers, service providers and airfreight. Following the pilot, the TTP is likely to be opened to all Australian participants in global trade. We expect this will likely occur late 2016 or 2017.

What should you be doing now?

You should now be assessing the proposed benefits to determine whether TTP accreditation is likely to positively impact your business. If you decide that you would like to join the TTP, you need to decide whether you would like to be part of the pilot (which is hoped to ultimately include 40 participants) or come on board when the TTP commences proper.

In either case, now is the time to start assessing the strengths and weaknesses in your trade compliance and international supply chain. Accreditation involves a review of your prior two years' trade compliance. What you are doing today will be directly relevant to your potential accreditation in 2017.

The first step towards accreditation is to complete a self-assessment questionnaire. We have reviewed and provided comments to Customs on this document. Please contact us if you would like to discuss this questionnaire and discover how it should guide your preparation for the TTP.

Remember, you don't need to reinvent the wheel. Your overseas related companies may be accredited under their respective systems. Learn from them about the internal policies and procedures that assisted with their accreditation.

2. Tax review – Are you making a submission regarding duty on CBUs?

The Government has released its Tax Discussions Paper seeking feedback from the community regarding a range of topics, including customs duty. Submissions are due by 1 July 2015 and should be directed at developing a tax system with lower, simpler and fairer taxes.

Customs duty is a protectionist tax and its role in respect to the auto industry should be judged in this light. When manufacturing of passenger motor vehicles ends in Australia there will be no local industry to protect and a strong argument will exist for the removal of the 5% duty on CBUs.

Such duty will already be removed under many FTAs, notably, in respect to Thailand, Japan, the US and Korea. Failure to remove the general duty rate will mean that duty will primarily

CUSTOMS DUTY IS A PROTECTIONIST TAX. IF THERE IS NO LONGER A LOCAL INDUSTRY, THERE SHOULD NO LONGER BE TARIFF PROTECTION.

be payable on European imports and for revenue raising purposes. Many would argue that this is an inequitable method to raise revenue.

General duty on CBUs would also be an inefficient tax. It would mean importers of CBUs from Japan, Korea, China, the US and ASEAN countries would have to comply with the red tape associated with FTAs to obtain a duty free rate. This regulatory step would serve no industry protection purpose.

If there isn't a drop in the general rate, the tariff concession system should be reviewed. Tariff concession orders (TCOs) cannot currently be made in respect of passenger motor vehicles and their components. Removing this restriction may be a less contentious way of ensuring that duty is not paid where there is no local industry to protect. However, if TCOs are permitted in respect of vehicle components there is likely to be arguments regarding what locally made goods are substitutable and whether a local producer has the facilities to produce a particular component. This may ultimately lead to an inefficient system.

Importers will be affected differently depending on their mix and source of imports. The key point is you now have a unique opportunity to contribute to the discussion about duty rates and the use of concessions. Now is the time to start preparing your submission ahead of the 1 July 2015 deadline.

3. Classification – When does a wheel bearing become a vehicle component?

Change is all around us, and sometimes it is your own products that are changing. While customs issues will rarely, if ever, dictate product or supply chain changes, customs should still be an important consideration.

The importance of considering customs when undergoing product change was demonstrated in the case of *Iljin Australia Pty Ltd and CEO of Customs* [2014]. This case primarily concerned the classification of wheel bearings fitted to front wheels. Iljin claimed the goods should be classified as ball bearings and fell within the terms of a TCO. Customs claimed the goods should be classified as vehicle parts, for which no TCO applied.

The Tribunal found that the goods were properly identified as wheel hubs for motor vehicles and classified them as vehicle components rather than ball bearings. Over the evolution of the product, it had moved from being a mere ball bearing unit to a component incorporating a hub (removing the need for a sub-axle or additional hub) and an ABS plug/pickup. These changes significantly altered the good and gave it the essential character of an integrated wheel unit.

The important lesson from this case is the need to reassess the customs treatment of your products as they change, this is particularly important for products which are currently imported duty free using a concession. It may be the case that if the historic classification/concession does not now apply, a new concession can be obtained or a different concession considered (such as an FTA). If the case is that 5% duty must now be paid, at least the business will be aware of this cost when making purchasing decisions.

4. Transfer pricing – No solution in sight?

The problem

Australian distributors of motor vehicles and components are often on the receiving end of a transfer pricing (TP) adjustment designed to ensure that an arm's length profit is made in Australia. Often this is by way of an adjustment to the cost of goods and involves a decrease in the cost of goods where profits are too low, and an increase where profits are above the target range.

Where the customs value is based on the price of the goods and a TP adjustment occurs, there should be a corresponding impact on customs values. Customs will commonly accept a TP adjustment to be applied evenly across all relevant imports for a particular period. This works well with duty collection as the importer can simply provide Customs with proof of the calculation and a cheque for the extra duty.

However, with refunds the situation is made difficult by Customs' insistence on a refund application being made for every import declaration. This is feasible where there are a low number of high value imports. However, for importers of components there will be thousands of entries for which the cost of obtaining a refund will outweigh the amount of the refund.

The end result is that you pay additional duty where there is an increase in the invoice price, but receive only a partial refund if there is a decreasing adjustment.

The refund provisions of the newly enacted Customs Regulations did not resolve this problem.

A DIFFERENT CUSTOMS VALUATION METHOD MAY RESULT IN BOTH TRANSFER PRICING CERTAINTY AND REDUCED DUTY.

A solution

The assumption many make is that even where parties are related, it is desirable or necessary to remain within the transaction value method of customs valuation. The main reason behind this is that practically, it is easiest to clear goods based on an invoice price. This results in the transaction value and the customs value always being linked.

However, for some importers there may be benefits in considering other customs valuation methods. These other methods break the connection between customs valuation and transfer pricing adjustments. While this means that you will not receive refunds for a downward adjustment; you probably are not currently receiving a 100% refund and this must be weighed up against the certainty of having to pay additional duty where there is an increasing adjustment and the annual compliance cost.

Where it makes sense, we have worked with importers to obtain rulings that other customs valuation methods be used. Often this is the computed value (cost plus) method and at times has lead to a significantly lower initial customs value, with no need to adjust if there is a TP adjustment.

Other times the computed value is identical to the initial invoice price (which is generally based on the manufacturer making an arm's length profit). However, there is no need to alter the customs value based on an end of year TP adjustment (which is really focused on the importer's profit and has no connection to the value of the goods).

Whether you're looking for a lower initial customs value or simply a method to remove the customs uncertainty, and often inequity of the TP adjustment, a different valuation method should be considered.

5. Customs compliance - are you requesting a refund or an audit?

Those with regional responsibilities would be aware that requesting a ruling or refund from some Customs Authorities is equivalent to requesting an audit. Historically, we've advised that the situation is not the same in Australia. However, over recent months we have observed a trend that many disputes with Customs are originating from refund requests.

In some cases the importer will have obtained a tariff or valuation advice and sought a refund on that basis, only to have the National Refund Centre reassess the ruling. On other occasions, a refund will only relate to one line of an entry, however, the National Refund Centre will audit every line of the entry.

When lodging a refund application you need to be sure that you can verify the customs treatment of each line of the relevant import declaration. This is particularly important if either you or a third party is undertaking a duty review of your entries. Such reviews are primarily focused on duty paid, and will pay less attention to the treatment of duty free entries.

This is particularly important for the auto industry where import declarations can contain hundreds of lines.

6. Tariff concession orders – becoming increasingly strict

For at least the past 12 months, Customs has been taking an increasingly stricter approach on the interpretation of TCOs. In 2014, the Administrative Appeals Tribunal in the Toro case held that for goods to qualify for a TCO, they must fit the TCO description precisely and have no more or no less than the characteristics set out in the description. This is an extremely onerous requirement, especially given the broadness historically used in TCO wording.

This approach was recently affirmed in the AAT case of Brand Developers Aust Pty Ltd and CEO of Customs [2015]. In this case a domestic food processor was found to fall outside the terms of a TCO because in addition to the parts described in the TCO, it also contained a vegetable peeler and a lid to be used post processing of the food. These items were held not to be part of the good and, as such fell outside the wording described in the TCO.

Tellingly, Customs also argued that the instruction manual accompanying the food processor took the good outside of the terms of the TCO. The AAT rejected this argument, likening the instruction manual to packaging. Although unsuccessful on this point, that Customs would argue for such a strict approach demonstrates the current attitude of Customs. If there is any argument that a good is outside the terms of a TCO, Customs will take it.

Many TCOs in the automotive sector are very specific and need to be so to ensure no overlap with local manufacturers. We recommend that you review which concessions are saving you the most duty and closely review the use of those concession in light of the current strict approach by Customs. You should be particularly careful where any consignments come with additional accessories or bonus / complimentary products.

7. China/Korea/Japan FTAs

China FTA

More than any other question, we are continually asked, when will the China FTA commence? With the fanfare last year around the conclusion of negotiations, a mid-2015 commencement date was touted. Given that we are yet to have the wording of the agreement finalised, let alone introduced into parliament and reviewed by a Senate Committee, late 2015 seems optimistic.

Some Government officials have said late 2015 is the goal as it is expected that one round of tariff cuts would occur on implementation and another on 1 January 2016. This is particularly important for Australia's exporters.

In the meantime, we suggest that you review past data for trade with China, identify the goods that might be subject to the greatest duty reductions and take steps now to start assessing whether the goods are likely to qualify. There are often similarities between the rules of origin under different FTAs. As such, we suggest that you review the relevant rules of origin under the New Zealand-China FTA, or the Japan-Australia or Korea-Australia FTAs to get an understanding of the likely rule of origin under the China-Australia FTA.

With that in mind, and remembering that nothing is certain until we see the text, you can start discussing with your Chinese suppliers whether your imports are likely to qualify under the Australia China FTA. This will position you well to take advantage of the FTA from day one of its introduction.

Korean and Japanese FTAs

We are already in year two of each of the Japanese and Korean FTAs. This will mean that some imports are into their second round of duty reductions.

If you elected not to undertake the work necessary to comply with either FTA based on the initial duty rates, we recommend reassessing whether that decision is still valid based on the further reduced rates.

In assessing the cost of compliance with each FTA, remember that under the Korean FTA the origin document can be completed by the manufacturer or exporter and under the Japan FTA the origin document can be completed by the manufacturer, exporter or importer.

While of course an importer should take care before certifying that foreign goods comply with the rule of origin in an FTA, related party importers are more likely to have access to the information necessary to make this certification.

Due to historically high duty rates and high value imports, automotive companies often have greater customs and supply chain resources than other industries. This positions automotive companies well to take advantage of the exciting developments such as new FTAs and the Trusted Trader Program. However, it also means that Customs will not grant auto importers the latitude that they may give a less sophisticated importer.

Our experience is that being proactive and strategic regarding customs duty is the best approach to ensure the highest utilisation of concessions, the lowest customs value and high levels of compliance. In an industry where landed costs and supply chain speed are crucial, those that merely react to change after it has occurred are likely to be at a competitive disadvantage.

ABOUT US

Hunt & Hunt has a specialised Customs and Global Trade team that has significant experience in assisting automotive clients including leading European, Japanese and US OEMs and component manufacturers with customs valuation, transfer pricing, the application of concessions and dumping duties.

More broadly, our corporate law team has extensive experience in assisting international automotive clients with a range of matters including drafting commercial agreements, intellectual property rights and the establishment of Australian business structures.

As the only Australian member of Interlaw, Hunt & Hunt is strategically aligned with commercial lawyers in every industrialised country in the world.

With eight offices across Australia, an office in Shanghai, together with our Interlaw alliance, our reach, just like our clients' issues, is not restricted to Australia. Our team provides you with local knowledge spanning many decades, underpinned by the collaboration of our national and international experience.

INTERLAW®
An International Association of Independent Law Firms

Authors: Russell Wiese, Partner | Lynne Grant, Special Counsel | Fran Smyth, Lawyer