WHITE & CASE

Trade in the balance: Europe's new Union Customs Code

New customs rules are creating fresh opportunities and challenges for every business that imports or exports goods in or out of the European Union

Europe's new Union Customs Code

The European Union—the world's largest trader of manufactured goods and services—is adopting a new framework of customs rules, the Union Customs Code (UCC)

From cutting-edge California mobile devices and Chinese manufactured products sold throughout Europe to French luxury items and German automobiles exported around the world, companies that can move their goods efficiently and cost-effectively across the European Union (EU)'s borders gain advantages in time and money.

Now, for the first time in more than 20 years, the UCC is changing the rules on the cross-border movement of goods in the EU—the world's largest trading block.

On the surface, the UCC may appear to be yet another set of prosaic regulatory updates. In fact, some of these changes affect basic principles of international trade and create challenges and opportunities for every business that imports or exports goods in or out of the EU.

With that in mind, here is a practical analysis of the EU's new customs rules.

THE NEW CUSTOMS RULES IN CONTEXT

The UCC, which takes effect on 1 May 2016, replaces the EU's previous customs code. The EU codified its customs rules for the first time as the Community Customs Code (CCC) in 1992. A longstanding process to modernize EU customs rules led to the adoption of the UCC in late 2013 and key implementing rules in December 2015.

Although the UCC will apply starting 1 May 2016, it may likely take until the end of 2020 to put in place all of the IT systems necessary to implement all UCC provisions. Transitional rules will apply in the interim.

The UCC is intended to achieve greater consistency among EU Member States on key customs issues and to create a fully interoperable electronic customs system linking the Member States' national systems through a single interface. The UCC should reduce customs compliance costs for certain "trustworthy" EU businesses, in an attempt to improve the balance between heightened security (through measures introduced following the 9/11 attacks) and easier international trade. At the same time, it will make the customs process more difficult for businesses that do not have this "trustworthy" status.

So this is a story of both added benefits and increased burdens.

"For the first time in more than 20 years, the world's largest trading block is substantially revising the rules on how to access a market of 500 million consumers.

> **The EU grants Member States considerable leeway to decide how they will interpret and implement certain rules.**

OBSTACLES TO A TRUE CUSTOMS UNION

The EU is a customs union, which means that all 28 EU Member States count as one territory—and that all Member States supposedly apply the same external tariffs to all non-EU imports and follow the same EU customs rules. In practice, the way companies clear goods through customs and the amount of import duties they ultimately pay can vary considerably, depending on the Member State in which they operate.

Despite a history of continuous revisions to the CCC and the replacement of the CCC with the UCC, the EU remains far from a true customs union. Building this type of union has been—and, under the UCC, will likely remain—a gradual process for several key reasons:

No central EU customs agency—In the United States (for example), US Customs and Border Protection enforces and interprets all US customs rules for all 50 states. The EU, by contrast, leaves each of the 28 Member States' national customs administrations largely in charge, inevitably leading to different decisions—even though they operate within the same framework. Insufficient political support for a powerful central EU customs agency reflects the tensions between EU-level institutions seeking broad consistency and most EU countries, which are reluctant to give up sovereignty in this area. This creates several hurdles for companies seeking to ensure that their EU competitors do not receive more favourable treatment than they do.

Broad discretion among Member States to implement certain rules—The EU grants Member States considerable leeway to decide how they will interpret and implement certain rules. As a result, varying national preferences have led to different enforcement cultures. For example, because Member States were allowed to develop electronic customs systems at their own pace (depending on their available resources and political will) and in their own way, companies now face 28 different electronic customs systems that are not linked together. In addition, some Member States currently allow companies to use certain simplified procedures without requiring a financial guarantee to cover potential customs duties, while others do not.

No consistent penalties for infringement—There are no consistent EU penalties for companies that infringe customs rules. This means an identical infringement (such as classifying a shipment under the wrong tariff heading) can create vastly different consequences in different Member States. Assuming that customs authorities discover an infringement in the first place (since their levels of audit and enforcement also differ), a company's penalty could range from simply self-disclosing the error and paying the unpaid duties (without a financial penalty) to possible severe criminal penalties and seizure of goods. A 2013 European Commission proposal for more consistent rules is progressing extremely slowly, and no revolutionary EU legislation should be expected in the short term on this topic.

Despite these obstacles to eventually building a true customs union, each EU Member State will have to implement the new UCC rules immediately. This will have far-reaching effects on global businesses.

28 European Union Member States (2015)

Austria	Estonia	Italy	Portugal
Belgium	Finland	Latvia	Romania
Bulgaria	France	Lithuania	Slovakia
Croatia	Germany	Luxembourg	Slovenia
Cyprus	Greece	Malta	Spain
Czech Republic	Hungary	Netherlands	Sweden
Denmark	Ireland	Poland	United Kingdom

NEW BENEFITS FROM THE UCC

By simplifying and consolidating certain customs rules, the UCC will likely create several new opportunities for EU importers and exporters. Some highlights include:

Simplifications for "trustworthy" EU companies

Currently, companies that meet EU criteria to be designated an Authorized Economic Operator (AEO) benefit from several "simplifications" (such as easier customs declarations and fewer customs controls on their operations) that increase the speed and lower the costs of the customs process for them.

Under the UCC, additional simplifications for companies that are AEOs for customs simplification (AEOCs) should over time lead to important savings in three key areas:

Centralized clearance—Once the necessary supporting IT systems are in place (planned for 2020), AEOCs will be able to handle all customs formalities for all Member States through a single customs office.

Entry in the declarant's records—AEOCs will be able to make their customs declarations in the form of entries in their own records (EIDR), rather than through normal customs declarations, and without having to present the goods physically to customs, as long as the supervising customs office has access to all information necessary to examine the goods, if it wishes.

Self-assessment—AEOCs with authorization to use the EIDR procedure may also be allowed to determine the amount of import or export duties payable and to carry out certain controls—tasks normally handled by customs authorities. These companies must then pay duties and submit details at regular intervals so that the customs authorities can check how the duties were calculated.

More uniform classifications of goods

The UCC will introduce more efficient procedures to define EU customs classifications. If Member States diverge on how to classify identical or similar goods, those Member States' experts and the European Commission will work within the special EU-level Tariff and Statistical Nomenclature Committee to determine uniform tariff headings. The UCC will improve the rules to foster more rapid discussions under strict deadlines. This should allow the European Commission and Member States to decide a common EU approach more swiftly in the future.

More flexible and user-friendly special procedures

Under the UCC, authorizations for customs procedures that suspend the payment of duties will last longer. Internet retail sales will be possible from customs warehouses. And other procedures will become more flexible.

For example, to obtain "inward processing" authorization (relief from customs duties and other charges for goods that are imported into the EU, processed and then exported outside the EU), companies will no longer need to show a clear intent to export the processed goods. They also will no longer owe compensatory interest if the processed goods are later cleared for free circulation within the EU. In addition, the customs duties calculated on imports after "outward processing" (which lets companies temporarily export goods from the EU for processing and then claim full or partial duty relief when they reimport the goods) will be based on the cost of the processing outside the EU, rather than the previous calculation (which was the amount of customs duties on the exported products minus the amount of customs duties on the reimported goods).

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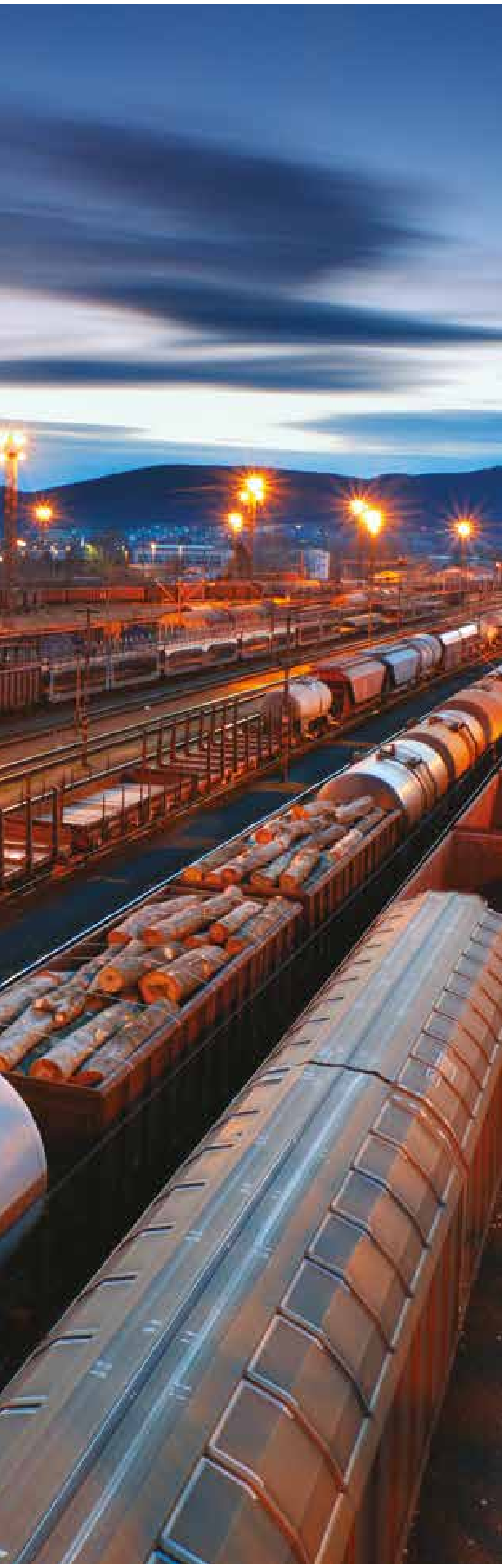


A "POSITIVE STARTING POINT" FOR A LONG MARATHON

Dirk Jensen, Manager of Trade Compliance in EMEA for Celanese Corporation, a global technology and specialty materials company, shared some perspectives on how his complex, multinational corporation will navigate the UCC's new rules:

Q: Do you think most companies are prepared to comply with the UCC in 2016?

Jensen: It's an enormous challenge for nearly all of us. The EU finally published detailed implementing regulations for the UCC only in December 2015. That left us just four months to understand the specific rules, alert our senior management to the likely impact of the impending changes and begin to adjust our internal processes.

Companies tend to plan annual budgets and other programs much more than four months in advance. The delayed regulations made it extremely challenging to identify the internal technological, financial and other resources we would need to adapt in time to request them for 2016. It also meant that external training providers are only now starting to offer UCC training programs to help prepare our in-house compliance teams.

Starting next year, it should be easier to plan and budget for internal systems adjustments, training programs, authorization applications and the many other steps we will need to take. At the moment, though, we are working as hard as we can to adapt our global business to the UCC's requirements.

Q: What aspect of the UCC is most likely to have a positive impact on your operations?

Jensen: Currently, the EU includes multiple, separate customs systems. The UCC's goal of a central customs clearance process at each point of entry into Europe could streamline our transport timeline significantly and strengthen our supply chain security.

For example, a container ship full of goods delivered to Rotterdam, the Netherlands, and destined for one of our facilities in Germany could arrive as much as two days earlier if it only needs to clear one European customs process. Having large amounts of materials more immediately available for our operations would be so beneficial that our internal team is already starting to get our systems and processes ready to present the proper electronic customs data as soon as this option becomes available and national customs systems can share information with each other.

Q: What is your view of the UCC's new approach to classifying goods?

Jensen: From our perspective, a more uniform classification approach throughout Europe would provide greater confidence in predicting the amounts of customs duties. Knowing that customs officials in (for example) Germany, the UK and Spain all will use the same classifications for goods will give us a more solid, reliable basis for future decision making.

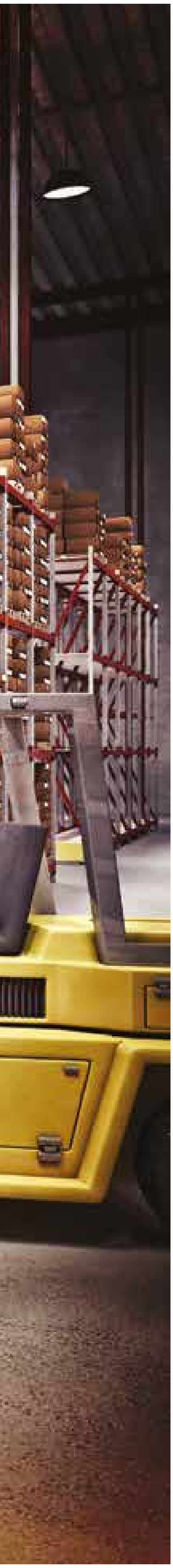
Q: Not all of your legal entities in Europe have become Authorized Economic Operators yet. Might that change once the UCC takes effect?

Jensen: The UCC has made applying for AEO status more appealing and necessary but also more challenging. Although AEO criteria will be more difficult to meet (including demonstrating a record of customs *and* tax compliance as well as in-house knowledge of customs matters), we will need AEO status to use certain simplified customs procedures. Applying for AEO status could also drive us to build more documented "trustworthy" internal processes. For us, these benefits may likely outweigh the costs and time involved in applying for AEO status.

Q: How do you feel overall about the UCC?

Jensen: This feels like starting a long marathon, where we have not had enough information until now to begin preparing to run. Adapting to the UCC and making full use of its opportunities in 2016 will be challenging for us in many ways.

At the same time, the UCC should over time improve several of Europe's customs processes and create more stability for the import/export community. So this is a positive starting point.



FIVE TIPS FOR ASIA-BASED EXPORTERS TO EUROPE

Vast quantities of goods flow between Asia and the EU each year, linking these two regions in powerful trade relationships.

China, Japan and Korea all rank among the EU's top ten trading partners, while Singapore is the EU's largest trading partner in the Association of Southeast Asian Nations (ASEAN). China, which contributed only 7 percent of the EU's total trade in goods in 2002, quickly rose to become the EU's second-largest trade partner by 2014.

These and other Asia-EU trade relationships are likely to remain robust and grow even further. This makes it critical for Asia-based exporters to understand how the UCC will affect them.

The EU's new rules are complex. The UCC's impact on Asian exporters also may vary, depending on each exporter's country of origin, industry sector and other business specifics. Nonetheless, some key tips apply for Asian exporters to the EU:

1. Remember: the "first sale rule" is no longer an option

Asia-based exporters often assume that the "first sale rule" (which previously allowed businesses to base their EU customs duties for imported goods on the first price paid in a chain of sale by a middleman to a manufacturer) is a normal business practice to be factored into the overall transaction cost. But now, the UCC's "last sale rule" requires customs duties to be based on the last price paid before goods are released for free circulation in the EU. (See "How the UCC increases customs duties for first sale rule users" on page 8.) Based on this, Asia-based exporters may wish to review their existing transaction structures with EU-based importers and decide whether to lower invoice prices for their EU importers.

2. Prepare to provide customs guarantees

The UCC's new provisions require businesses to provide guarantees to ensure payment of any customs duties. This means Asia-based companies exporting to the EU will need to take stock of inventory and plan ahead—both in terms of available cash on hand and for annual budgetary planning.

3. Consider becoming an AEO

Under the UCC, companies that meet Authorized Economic Operator (AEO) criteria can provide lower guarantees and receive several other benefits. Obtaining AEO status becomes even more important for Asian businesses with subsidiaries or branches in the EU. Asian businesses that have not yet applied for AEO status should now give serious thought to the process. They also should establish in-house internal compliance training programs or seek external assistance to ensure they benefit from all possible trade facilitative simplifications under the UCC.

4. Plan carefully before requesting Binding Tariff Information

Binding Tariff Information (BTI) is a useful tool to know in advance the tariff classification of goods and, accordingly, the amount of the customs duty. A BTI may be obtained from the customs authority of any EU Member State and will be binding for three years. However, Asian exporters now must be more careful when requesting a BTI and, in particular, when constructing classification arguments and selecting a customs authority. This is because the UCC will no longer permit businesses to "forum-shop" and ignore a BTI if it is unfavorable to them.

5. Be ready to show proof of origin

Asia-based companies that use the EU's Generalized Scheme of Preferences (a program that makes it easier for developing countries to export their products to the EU by letting them pay lower customs duties) should also note the UCC's new requirements to provide proof of preferential origin for imports. While this additional requirement is not overly burdensome, internal awareness and preparation could save time and money in the customs clearance process.

KEY CHALLENGES UNDER THE UCC

The UCC will pose several challenges for businesses as well. Some particular issues include:

Guarantees generally required

Under the previous CCC, Member States had the discretion not to require companies to provide a financial "guarantee" (either as a cash deposit or a written agreement to pay) in order to ensure payment of any customs duties that might be incurred later (for example, after full details about specific goods and their final destinations become clear).

Under the UCC, all customs procedures generally will require companies to provide a guarantee covering existing or potential amounts they might later owe to a customs authority, including for example: placing goods in temporary storage. This will require companies to tie up more money in guarantees in certain Member States. For example, the United Kingdom will now require a guarantee for new inward processing authorizations.

Companies that meet AEO criteria may benefit in several ways, including being able to provide a comprehensive guarantee that covers more transactions or receiving waivers or reductions of the guarantee amount normally due. If no guarantee was required under pre-UCC authorizations, this will remain the case until these authorizations are reassessed.

More demanding AEO criteria

Under the UCC, AEOs will have to demonstrate a good record of compliance with both tax and customs rules and a sufficient level of relevant in-house practical expertise to handle customs matters.

Generally speaking, EU companies seeking to become or remain AEOs will have to strengthen their internal compliance policies and procedures and ensure appropriate training of key staff. Because certain customs simplifications under the UCC will require compliance with AEO criteria, companies that have not yet gone through the AEO process will need to assess whether to do so now.

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EU importers will no longer be able to use the "first sale rule" as the basis for a customs valuation.

New valuation rules and likely higher duties

EU importers will no longer be able to use the "first sale rule" as the basis for a customs valuation. The first sale rule previously allowed importers to pay customs duties based on the (usually lower) price paid by a middleman (an intermediary vendor) to a manufacturer of goods instead of the (usually higher) price paid to that middleman by an EU importer. Instead, the "last sale price" before goods are released for free circulation in the EU now must be the basis for a customs valuation, unless the import was based on a valid contract concluded before 18 January 2016 (in that case, the contract can be relied on until the end of 2017). This will increase customs duties for current first sale rule users and create a competitive disadvantage compared to US importers, for example, which may still use the first sale rule. See "How the UCC increases customs duties for first sale rule users" below.

In addition, an ambiguously phrased UCC implementing provision could lead to sales from EU customs warehouses serving as the basis for customs valuations, which could affect companies that traditionally operate from warehouses.

The UCC may also require companies to pay customs duties on all royalties and license fees. Under the CCC, in line with international trade law, these were only included when they were related to the goods and their payment was a condition of the sale. Under the UCC, this condition is less likely to be checked systematically.

In addition, the UCC will require companies to comply with additional criteria when they seek authorization to use a simplified valuation process (for example, if all elements necessary to calculate a customs value are not available at the time of import and a customs authority agrees to determine the customs value for particular goods based on specific criteria).

Binding Tariff Information requests create greater risk

Companies looking for increased legal certainty about their products' classifications upon import into the EU can seek Binding Tariff Information (BTI) from a national customs authority. A BTI permits the relevant EU customs authority to decide the appropriate tariff heading, and then all other customs authorities in the EU must respect this decision when the BTI holder's goods are imported into their territories. Under the CCC, when a BTI dictated a different tariff heading than the one suggested by the applicant, the BTI holder could easily ignore a "bad" BTI if it resulted in a higher duty rate. However, under the UCC, existing and new BTIs will become binding on BTI holders, which must explicitly declare them in their import declarations.

Different origin rules apply

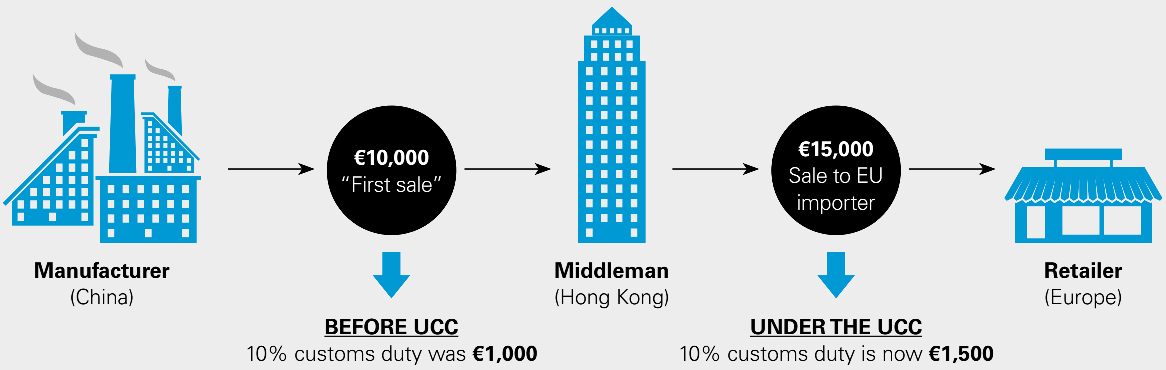
For various reasons (such as to determine whether or not commercial policy measures apply, for possible origin labelling or for statistical purposes), a "non-preferential" origin must be determined for all goods imported into the EU. Under the CCC, this origin was (with few exceptions) considered to be that of the country in which the "last substantial transformation" of the product occurred. The UCC replaces that vague origin concept with more precise criteria by product category.

Some companies may prefer this more objective approach, since it provides greater legal certainty. For others, it could result in origin changes and possibly anti-dumping duties on certain products. Companies will need to assess their particular products against the new rules to determine possible implications.

Existing authorizations reassessed

Certain types of customs warehouses will no longer exist under the UCC. This means companies will have to apply for new authorizations to use the remaining warehouse options.

How the UCC increases customs duties for first sale rule users



Customs duties are often determined as a percentage (10 percent in this example) of the value of goods. Goods often cost less for the "first sale" in a supply chain than they do for later sales. So, current first sale rule users are likely to pay significantly more for customs duties under the UCC, depending on their individual supply chain structures.

Existing CCC authorizations will remain in place until the earlier of their expiration date or 30 April 2019. By 1 May 2019, all existing authorizations will be reassessed, which may, for example, entail different duty calculation rules for goods covered by "inward" or "outward" processing rules.

THE LIMITS OF CHANGE

Many companies will see little or no UCC-related changes when using certain duty-saving opportunities or trying to protect certain interests.

For example, the EU's duty suspension and tariff quota rules remain available for EU companies unable to source sufficient amounts of components or intermediate materials within the EU for their EU production sites. In these cases, companies can apply for temporary suspensions of normal duties for "input" materials. If a suspension could damage planned or existing EU production of these input materials, the affected EU companies can oppose it. The EU list of suspensions and tariff quotas is updated twice per year, which means companies still have regular opportunities to apply for or oppose a suspension.

The UCC generally does not change any preferential tariff arrangements. One limited exception is new requirements to deliver proof of preferential origin for imports under the EU's Generalized Scheme of Preferences (which allows developing countries to pay lower customs fees when exporting to the EU) starting 1 January 2017.

Companies can continue, in certain cases, to obtain a downward revision of the value of goods or import duty amounts or a refund (for example, if goods are defective or if tariff preferences were not claimed at initial import but proof of origin can be supplied later).

Companies also will remain able to invoke the "good faith clause" in certain circumstances—though meeting the precise conditions will remain a challenge. For example, this could be an option to avoid payment of full customs duties when a company has claimed preferential tariff treatment for an imported product that later turns out not to have satisfied the relevant preferential origin rules.

Finally, the UCC will not affect the EU's current customs laws protecting intellectual property rights. Companies fearing that others are importing counterfeit goods into the EU can still ask customs authorities to stop those goods at the border so that court actions can be filed against an alleged infringer.

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> **US companies trading globally must bear in mind more than ever that the EU customs rules may differ in important respects from US customs rules.**

AIMING FOR COMPATIBLE CUSTOMS RULES, BUT DIFFERENCES REMAIN

The EU and the United States (US) form the world's largest bilateral trade relationship. So the introduction of new customs rules in the EU will significantly affect US traders.

Post-UCC, US companies trading globally must bear in mind more than ever that the EU customs rules may differ in important respects from US customs rules.

While the US and the EU continue to strive for compatible customs rules through various negotiations and arrangements, the UCC will result in important new differences in the customs treatment of goods while retaining some key differences already in place. A few important examples include:

"First sale rule"—The removal of the ability to use an earlier sale price as the basis for a customs valuation in the EU is likely the most important change from a US perspective, as the "first sale rule" remains firmly in place in the US. In the future, the basis for valuation in the EU may differ considerably from the basis in the US, including for royalties and license fees. US traders will need to prepare for this change.

C-TPAT v. AEO—Under a current bilateral customs cooperation agreement, the EU and the US mutually recognize each other's trade partnership programs (the Customs-Trade Partnership Against Terrorism [C-TPAT] in the US and AEO in the EU) to reduce administrative efforts and time required for customs clearance.

However, while the UCC's more demanding criteria for trusted traders may bring the EU AEO program more in line with US expectations that companies have a strong compliance program, there are still important differences between the two programs. For example, additional simplifications introduced under the UCC are only available for companies that are AEOs for customs simplification (AEOCs), which fall outside the mutual recognition arrangement with the US (which only covers AEOFs and AEOSs [AEOs with a security and safety certificate]). Companies should be careful not to assume that qualifying as an AEOC in the EU entitles them automatically to receive C-TPAT benefits in the US—and vice versa.

Penalties and prior disclosure procedures—In both the EU and the US, an importer that discloses a customs violation to the authorities before they have initiated an investigation can sometimes thereby reduce the amount of any penalty assessed against it (though not the amount of any duties it owes). The UCC does not change the EU's framework for penalties or potential prior disclosure procedures, which continue to be largely determined by the individual EU Member States. Considerable differences will remain between US and EU approaches in this regard, with the additional complexity that enforcement rules in the EU may differ to a large extent from one Member State to another. So if there is a potential customs violation, a US trader cannot approach an EU Member State customs authority and rely on the strategy it follows with US Customs and Border Protection. While the US rules are relatively clear-cut in this context, there is still considerable uncertainty in many EU Member States.

The EU and the US are currently negotiating a Transatlantic Trade and Investment Partnership (TTIP) Agreement, which will contain a chapter on customs and trade facilitation. The overarching aims of this chapter will be to streamline customs rules and controls, facilitate trade between the EU and the US and generally make the procedures more efficient for all stakeholders.

To adopt simple and effective bilateral rules under TTIP, the EU and US customs authorities will need to continue to work together closely. The introduction of the UCC makes this prospect more complex, as it will take the EU some time to get the full UCC apparatus up and running and ready for potential streamlining with the US customs framework (especially the necessary IT systems).

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