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KPMG Trade & Customs Hot Topics

January 30th, 2018

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Agenda

- Drawback Update

- Tax Updates
  - U.S. Tax Update as it Relates to Customs
  - Global Rules: Base Erosion and Profit Sharing (BEPS)

Duty drawback

CBP & regulatory updates – Duty drawback

Expansion and simplification of drawback rules provide enhanced duty savings opportunity for companies

The Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA) was signed into law by President Obama on February 24, 2016, with an effective date of February 24, 2018

Statistics:

— $804.7M in drawback claims in 2015

— More than 14,000 Claims in CBP's backlog

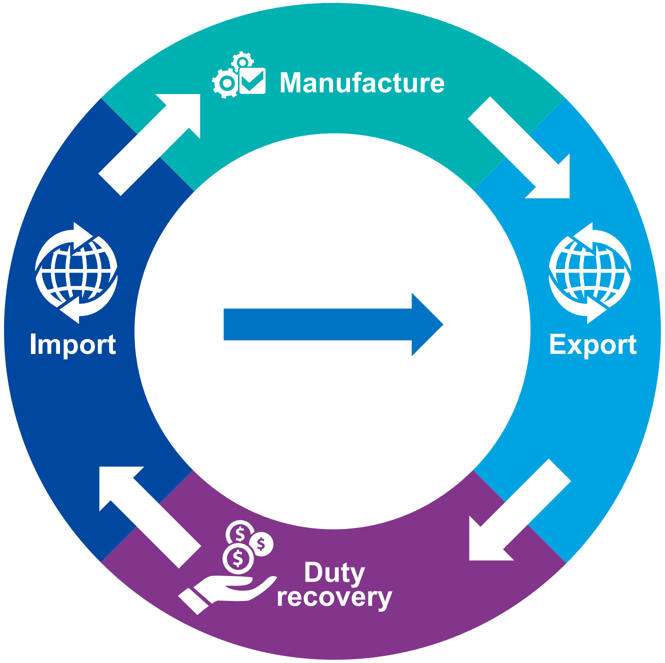
Key changes under TFTEA:

— Substitution drawback on 8-digit HTS level

— Simplified timeline

— Modernized documentation requirements

— Lesser-of calculation: the lesser of the value of the imports vs. exports
will be the amount utilized to calculate the 99% refund



TFTEA and duty drawback eased substitution rules

The new rules ease the commercial interchangeability requirement for substitution drawback by allowing a match to the 8-digit tariff classification to the imported article. As a result, significantly more products will be eligible for substitution drawback.

6110		Sweaters, pullovers, sweatshirts, waistcoats (vests) and similar articles, knitted or crocheted:		
		Of wool or fine animal hair:		
6110.11.00		Of wool		16%
		Sweaters:		
	15	Men's (445)	doz. kg	
	25	Boys' (445)	doz. kg	
	30	Women's (446)	doz. kg	
	40	Girls' (446)	doz. kg	
		Vests, other than sweater vests:		
	50	Men's or boys' (459)	doz. kg	
	60	Women's or girls' (459)	doz. kg	
		Other:		
	70	Men's or boys' (438)	doz. kg	
	80	Women's or girls' (438)	doz. kg	

...but not for exports to NAFTA countries.

CBP & regulatory updates – Duty drawback

Important Note: if products are classified under a tariff classification beginning with "Other," then a 10-digit classification match is required. This significantly reduces subjectivity while helping to ensure that goods are commercially interchangeable based on the same principles as the new 8-digit tariff match.

9405.10		Chandeliers and other electric ceiling or wall lighting fittings, excluding those of a kind used for lighting public open spaces or thoroughfares:		
		Of base metal:		
9405.10.40		Of brass		3.9%
	10	Household	No.	
	20	Other	No.	
9405.10.60		Other		7.6%
	10	Household	No.	
	20	Other	No.	

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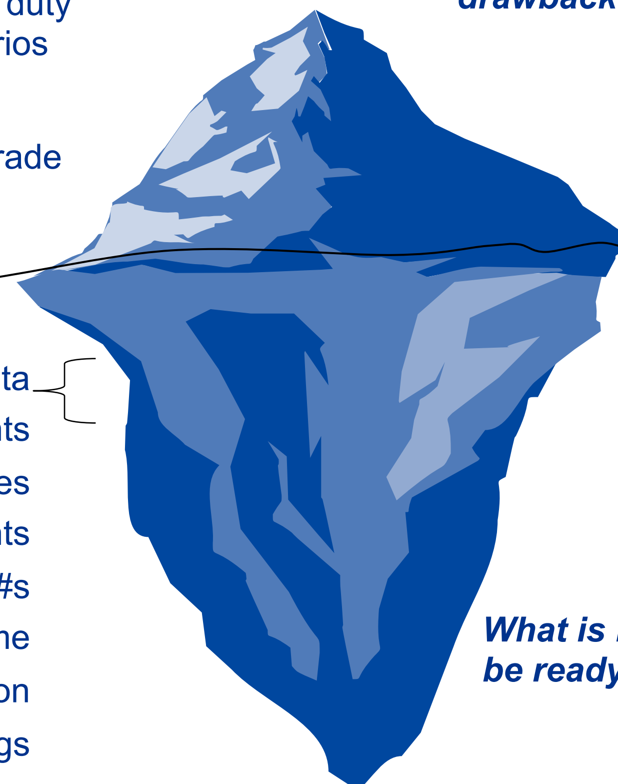
Duty drawback – “The Iceberg”

What is in view:

Ability to request a duty refund on imports with duty paid, subsequently exported for various scenarios (unused, manufacturing, rejected goods, etc.)

The changes from the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA)

How we can qualify for a drawback refund.



What is harder to assess:

“Clean” data
Supporting documents
Cooperation from 3rd parties
Matching supply chains to requirements
Developing a strategy regarding IOR #s
Anticipating benefits from expanded timeframe
A process to manage drawback information
Visibility and a proactive approach to filings
Audit preparation

What is needed to really be ready for drawback.

How will the new rules will be implemented in Feb. 2018? Will ACE even work?

Duty drawback – A new “lesser-of” calculation

Claimants must take the lesser value of goods of what is imported or what is substituted in the manufacturing process to account for exported merchandise. For example:

— Company Z **imports two luxury cars and three sedans**, but subsequently **exports only one luxury car and two sedans.** In order to increase savings with the new lesser-of calculation for those vehicles, the trade data and drawback claim should be analyzed in order to pair similarly valued products for filing a drawback claim.

- **Scenario 1:** *One of the two imported luxury cars and two of the three imported sedans are declared* with the exported luxury car and two sedans in Company Z’s drawback claim.
- **Scenario 2:** *All three imported sedans are declared* with the exported luxury car and two sedans in Company Z’s drawback claim.

Scenario 1 demonstrates increased savings under the new drawback regulations. All imported goods were paired with similarly valued goods. If Company Z had used scenario 2 for a drawback refund, the lesser-of calculation would have prevented it from obtaining all its potential savings due to the method in which it used to submit its drawback claim.

Duty drawback – Other provisions

Some additional provisions include:

— Liability for Drawback Claims – Joint and Several Liability will exist between the claimant & importer.

Insights: Who's bond will CBP go after under accelerated payment? Claimant? Importer? Both?

— Recordkeeping – 3 years from date of liquidation of the claim as opposed to 3 years after payment of the claim.

Insights: CBP may liquidate claims months later than when the claim is paid. Important to update the company's recordkeeping procedures to reflect *3 years from liquidation of the claims.*

Considerations

Questions to ask when applying the eased substitution rules:

1. Have you conducted a classification review lately?
2. Does your company have multiple importers and exporters of record?
3. If already applying substitution drawback, consider whether waiting until the eased rules go into effect to file your next claim may help increase your overall refunds?
4. If you missed out on drawback for exports in 2013 and 2014 under the old rules, determine whether these exports are now in scope?
5. Have you conducted a savings analysis based on the lesser of calculation?

CBP application of the new rules during the Interim

- CBP will not issue the regulations for comments to the community
- CBP will not have sufficient time to finalize the regulations prior to February 24, 2018
- Finalization of the regulations is speculated to be completed around July/ August of 2018
- After February 24, 2018, importers may submit claims to CBP under their interpretation of the draft rules
- Once the rules are finalized, CBP will begin to review claims that were previously submitted. We anticipate many claims will then need to be amended by the importer.
- Customs may not process TFTEA claims for accelerated payment until new regulations are final
- There is a 12 month transition period for drawback claims. During this time importers can choose to file claims utilizing the current method or under the new TFTEA rules
- There are several areas for drawback filings under the TFTEA in which we need final regulations for interpretation

U.S. Tax Update as it Relates to Customs

A trade and customs perspective

U.S. Tax Reform Update

- Boarder Adjustment Tax - Eliminated
  - BAT unpopular with U.S. retailers/importers
  - July 27, 2017 – “Big Six” tax reform negotiators indicated that it has decided to “set this [BAT] policy **aside** in order to advance tax reform.”
- Tax Reform Background / Update:
  - On December 22, 2017 President Trump signed H.R. 1 into law
  - The new law completes a long process in pursuit of tax reform
  - Most of the new law was effective on Jan. 1, 2018, though some provisions have delayed (or other) effective dates
  - The massive bill cuts taxes by $5.5 trillion, increase taxes by more than $4 trillion, and reflects a net tax cut of $1.5 trillion
  - The bill will almost certainly be subject to changes, corrections and regulatory interpretation over the coming years
  - Goal of reform is to bring back operations to the US
  - Lower corporate tax rate to 21%

Base Erosion Anti-abuse Tax ("BEAT")

What is BEAT?

— This applies to certain large taxpayers and will generally impose a minimum tax on certain deductible payments made to a foreign affiliate, including payments such as royalties and management fees, but **excluding** cost of goods sold ("COGS").

How can a company determine if the related party royalty payment subject to BEAT?

— In the instance where a royalty relates to inventory:

  — production royalties (e.g., related to manufacturing processes) will be excluded from the BEAT

  — while purely sales-related royalties (e.g., trademarks) will be taxable

Base Erosion Anti-abuse Tax (“BEAT”) (cont’d)

How can we assess from a customs perspective?

- Any restructuring to the supply chain that have BEAT implications may also have customs value/duty implications
  - For example, there may be increases to the COGS/customs value and duties for imported goods that may need to be addressed.
- The Trade and Customs department should be involved in any strategic tax planning that impact COGS or supply chains, resulting from tax reform.
- Specifically, Trade and Customs teams can:
  - assist in feasibility / calculate additional customs duty costs, if any;
  - potentially mitigate / reduce additional duty costs where possible (e.g., First Sale, FTZs, duty drawback, etc.); and
  - address any trade and customs compliance issues that may arise (e.g., customs compliance and export controls).

BEPS Impact on Global Customs

Former Tax and Trade Environment

No Global Visibility

No Communication Among Tax Authorities

No Exchange of Information Among Tax Jurisdictions

Fractured Tax Planning

Inability to Review Global Tax Positions

BEPS Background

In 2013, the Organization for Economic Cooperation and Development (OECD) initiated the BEPS Action Plan to counter tax planning techniques - Aimed primarily at income taxation of multinational enterprises (MNEs)

Base Erosion and Profit Shifting (BEPS) refers to tax planning by MNEs that inappropriately reduces the corporate tax base in high-tax jurisdictions where they operate and shifts income to low tax jurisdictions or even creates non-taxed income ("profit shifting").

15 Action Items with transfer pricing directly implicated in four of them.

Focus is to re-allocate profits where value is created.

Adopted in 2016 / MLI signed in 2017

2016 is the first year for which Country-by-Country Reports (CBC) are being filed

Background BEPS (con’t)

Participating BEPS Countries?

- Adopted by 68 jurisdictions across all continents and levels of economic development
- U.S., Europe, Canada, Australia, and most Asian and South American countries including China, Japan, India, South Korea and Brazil, Argentina and Chile

Automatic Exchange of Information?

- Master File: High-level information on global business operations and TP policies, complete with org chart, description of intangibles, and financial and tax information (Not submitted in all countries)
- Local File: More detailed information specific to each country where the MNE conducts business, including detail on specific related-party transactions involving that country (Not submitted in all countries)
- Country by Country Report – information relating to the global allocation of a MNE’s income and taxes together with certain indicators of the location of economic activity (only CbyC Reports are exchanged between tax authorities)

Is BEPS Mandatory?

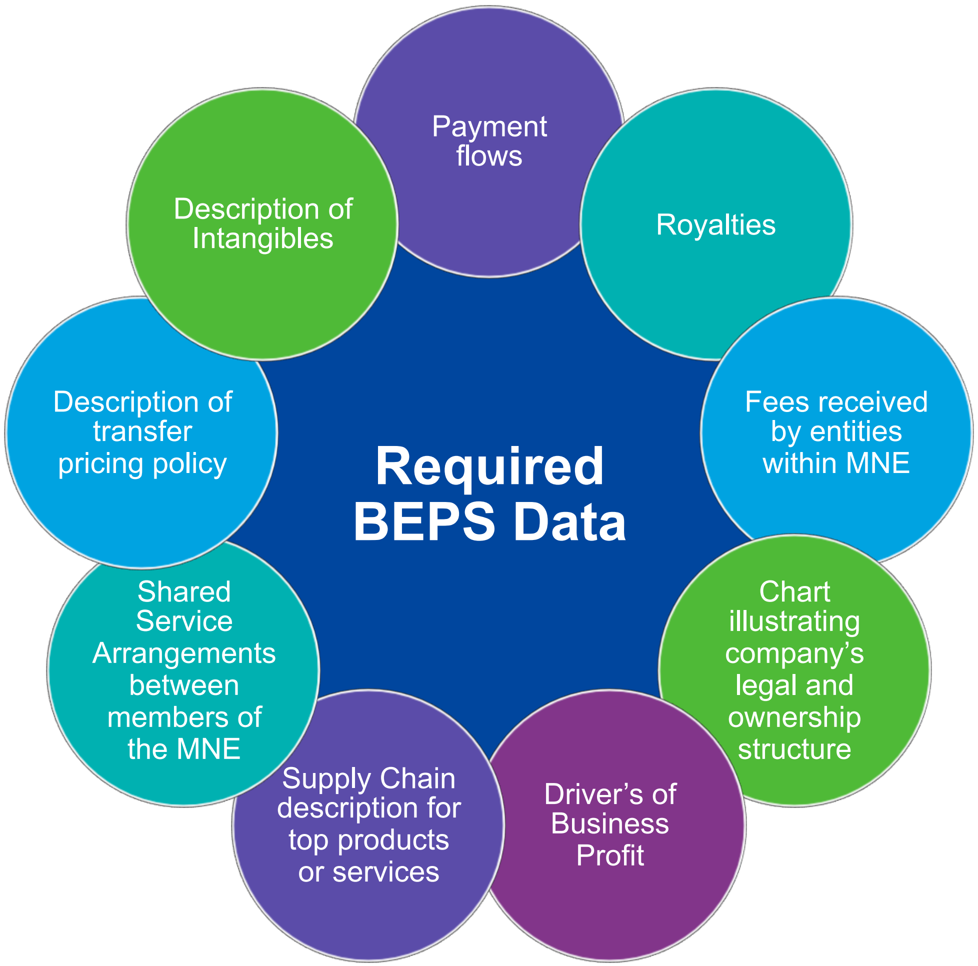
- Will impact most multinational companies
- Some BEPS Action Items have minimum standards that countries must meet while other countries recommend best practices or common approaches
- CByC: $850 Million USD / 750 Million Euros (Global Sales threshold)

CbC Reporting Requirement Example

CbyC Template																
			Activities													
Country	Constituent Entities Resident in Country	Country of Organisation or Incorporation if different from Country of Residence	R&D	Holding or Managing IP	Purchasing & Procurement	Manufacturing & Production	Sales, Marketing & Distribution	Administrative, Management & Support Services	Provision of services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant	Other
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

***Information obtained from Annex III to Chapter V of OECD/G20 Base Erosion and Profit Shifting Project: Guidance on Transfer Pricing Documentation and Country-by Country Reporting**

Examples of Transparent Customs Data



Data Available to Global Customs Authorities

- Function of Each Related Party
- Supply Chain Product Flows
- Related Party Revenue
- Royalty and License Payments*
- Transfer Pricing Policy and Adjustments*
- Stated Capital by Country
- Profit and Loss Information

* Most likely in preparation reports

Example Chief Trade Officer Questions

Under BEPS, information about additional dutiable values is available in the Master File and Country-by-Country Report.

Companies should think about the following:

- Where is IP held and are royalty and license fees properly included in the dutiable value of imported goods?
- Is the value of services, raw materials, or equipment transferred between related entities accurately reflected in the declared value of the merchandise?
- Does an entity have employees to support its claim to be a bona fide buyer or seller?
- Is an importer purchasing from a related entity and able to provide acceptable evidence of arm's length pricing? (Note: CbyC is at the country level
- Has the dutiable value of imported goods been properly adjusted for any retroactive transfer price adjustments? (Customs Authorities will not see this data directly in the CbyC report.)

Connecting the Dots (Customs – VAT – TP)

BEPS will require MNE to restructure their supply chain

Identifying "Trigger Points" of 3 disciplines

Topics that can impact another discipline

Transfer pricing	Customs	Indirect tax
Method/desired profit benchmark	Customs value	VAT calculations
Cost of goods sold	Classification	Registration
Profit results	Duty payments	Invoicing
Royalties/licensing	Free trade agreements	Cash flow
Retroactive adjustments	International commercial terms	Reporting
Function and risk	Circumstances of sale	VAT grouping
Permanent establishment	Importer/exporter of record	Title transfer
Tax structure	Country of export and import	Formalities
Value chain	Bona fide sale	Vendor contracts
Commissionaire structures	Import/export declarations (documentation)	
	Product descriptions	
	Exchange rate	

Chief Trade Officer Be Aware….

BEPS: Common supply chain changes

- Changing between commissionaire sales and low risk distributor sales
- Sudden import valuation changes to historically consistently priced goods
- New royalty payment paradigm which may be deemed as dutiable
- Jurisdictional requirements to establish a new entity as importer of record or non-resident importer.
- New commercial document templates to meet local import/export requirements
- Adjustments to the company's ERP system to account for the new supply lines and title transfers
- Potential to benefit from new duty saving opportunities such as tariff engineering, free trade agreements, foreign/free trade zones, duty drawback, and first sale for export.

Thank you

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