

Trade Agreement benefits - Shift in importer's accountability

September 2020

Our point of view:

Customs has rolled out **Customs (Administration of Rules of Origin under Trade Agreements) Rules, 2020** making the importer directly accountable for detailed origin related information. These rules provide a more transparent basis for customs approach to verification of origin and are likely to prevent possible misuse of benefits under Trade Agreements. These rules are effective for shipments arriving in India after **21 September 2020**. These rules will impact **imports coming from major Trade Agreement partner countries** like ASEAN countries, Korea and Japan.

These rules **change the rights and obligations of an importer** in more than one way, namely:

- **Direct accountability** to customs in relation to correctness of the origin claim
- Ensuring **availability of detailed contemporaneous information** from the exporter
- Alignment of importers and exporters supply chain information flow and **data flow**
- **Change in business process** relating to origin administration

Managing the cost saving on account of Trade Agreement benefit would require owners of financial risk i.e. Finance head or Business head, to lead this transformation. The new origin management process would require **one time effort to set up the processes** to review the eligibility for each product category, bill of material etc. **and an ongoing effort to have shipment by shipment contemporaneous data** and rules of origin eligibility review.

Once the information availability is addressed for each shipment, importer would have to be mindful of **responsibility to demonstrate of 'reasonable care'**. The term 'reasonable care' has not been defined in the rules and hence would be open to interpretation. We can expect intense **engagement between businesses, customs administration and judiciary on interpretation of the term reasonable care** and its consequences for importers.

“There is a major shift in importer's accountability to Customs on origin claims. Business processes supporting contemporaneous availability of origin related information and data flow from exporter would be very critical.”

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India's current Trade Agreement framework

Current Trade Agreement framework

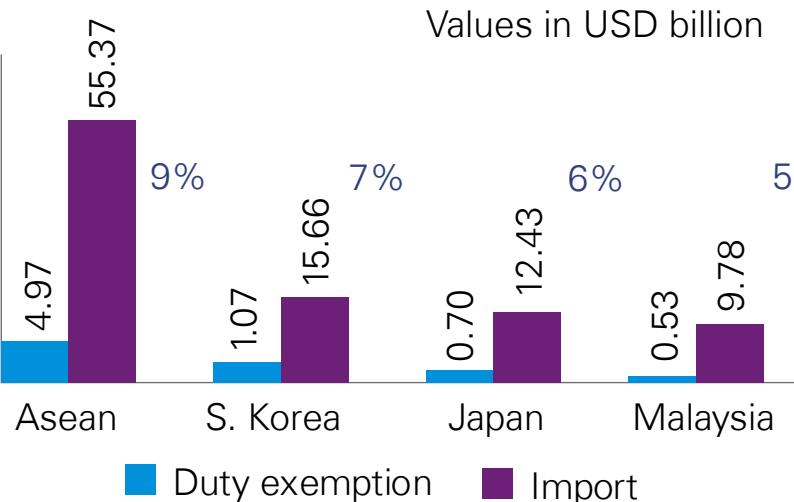


Key trade agreements with India : ASEAN-India, India-Japan, India-South Korea, India-Malaysia, India-Singapore



Approximately **20%** of India's imports are from Trade Agreement partner countries (graph below).

India's import and duty exemption



Total customs duty exemption – USD9.39 billion

Total import - USD93.25 billion

Global practice for administration of origin

- **Registered/ Approved exporter** - REX for European Union, Approved Exporter System for South Korea - Eligible exporters to register in importing country; Importing country getting right to audit exporters
- **Importer to establish reasonable care** (USA) - Onus on importer to justify origin of goods.

Rationale for change

Transparency in customs verification process of origin claims

In-country check before initiating verification from exporting country

Prevent misuse of Trade Agreements

Make importers accountable to customs on origin claim

Support India's flagship callout for Make in India

Source: Export import data bank, website of the Ministry of Commerce; Statement of revenue impact of tax incentives (Annex 7), Union Budget 2020-21

New origin administration - Shift in responsibility to importer

Existing process flow



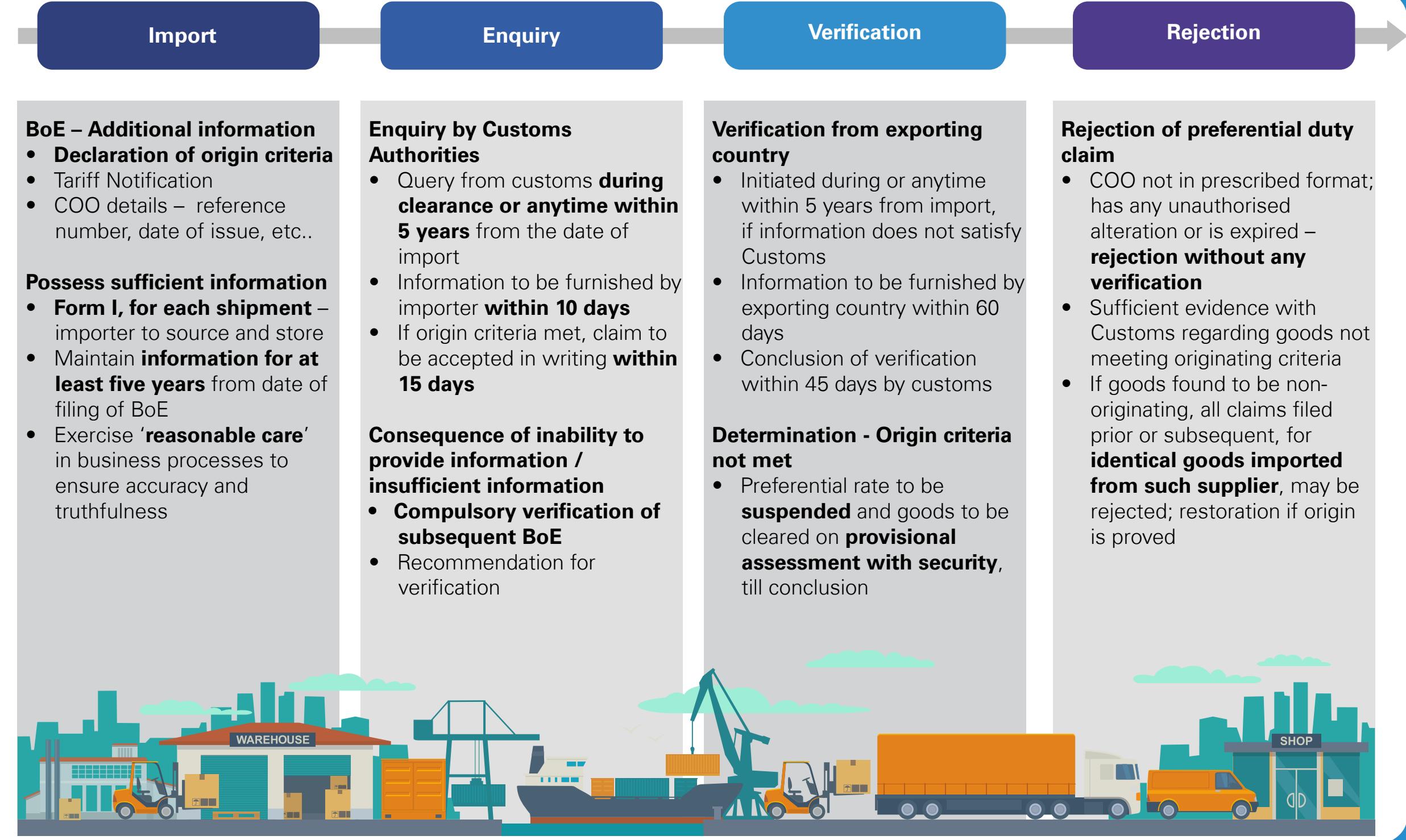
Reasonable care aspects to be embedded in the core business processes

Process flow w.e.f Sept 21, 2020



The above timelines depicts time taken in working days

Paradigm change - Granularity of origin data, life cycle of origin defense



The above timelines depicts time taken in working days

Challenges of data - confidentiality, source, usage...

Data related challenges for exporter/ importer

Source of data from depth of supply chain



- High dependence on various stakeholders – exporter/ third party suppliers, for sourcing critical business information e.g. manufacturing processes, cost of material, profit etc.
- Sourcing data in a complex, intermediary driven supply chain, third party invoicing, contract manufacturing etc.
- Availability of **supplier's declaration** on a real time basis – additional commitment of resources, establishing new data channels and applying data filters.

Data confidentiality



- New ways of looking at origin related data and handling of data - essential and non-essential, business sensitive and otherwise, etc.
- Fresh look at transmission of information through the compliance channel – importer, customs broker, authorities – how to ensure data does not become public.

Use of data by other authorities and regulators



- Likelihood of other authorities like customs valuation, transfer pricing authorities developing interest in cost and profit data of exporter from a very different perspective
- Business to have a fresh look on new data elements and its implications on other compliances.

Continuous data update in dynamic business environment



- Need for a continuous process of information update in the dynamic business environment – change in supply chain, sourcing footprint, tax structure, transfer pricing policy etc.

Key import product categories from ASEAN, Japan, Korea*



Electrical Machinery
(Import value - USD12.93 billion)

Mineral fuels and oil
(Import value - USD11.49 billion)

Heavy machinery and equipment (Import value - USD10.86 billion)

Animal or vegetable fats and oils (Import value - USD5.06 billion)

Iron, steel, copper
(Import value - USD4.17 billion)

*Source Comtrade data - trade statistics

Business impact - Accountability, risks and change in internal controls

1 Impact on businesses – Risk of cost escalation

- Risk of cost increase for businesses with **high utilization under Trade Agreements**, high volume of import from ASEAN countries, Japan and Korea
- **Possible disruptions because of** investigations, detention, delay etc.
- **Transmission of risk** to other importers sourcing from the same supplier.

2 Risk mitigation I - Stakeholder coordination

- **Attention to details in case complex supply chains** - third party invoicing, back to back COOs, multi-stage value additions etc
- **Alignment with Suppliers to source origin related information**
- Change in **business processes** – disclosure in BoE, maintain Form I, change in IT systems, data flow
- **Review by third party experts in case of doubt**

3 Risk mitigation II - Internal controls, responsibility...

- **Aligning controls, role and responsibilities**
 - Detailed business processes and controls
 - Internal ownership of financial risk, escalation matrix,
 - Insourcing vs. outsourcing the skill set,
 - Third party external specialist support etc.
- **Role of market intelligence** – Defaults at exporters end could mean denial of benefits to other importers – important to be plugged in to external intelligence

4 Pre-dispute consultation, dispute resolution

- **Test of reasonable care** – Organization to develop its own view on reasonable care built into business processes
- **Interaction with Customs** - enquiry and verification stage, to be monitored by strategic team, third party experts
- **Disclosures and submissions** to include bonafide and defense against allegation of mens rea and penalty
- Important role of **suppliers declaration, third party expert opinion, advance ruling etc.** in risk mitigation strategy

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