SYSTEMIC REPORT

MAIN PROBLEMS FACED BY BUSINESS IN CUSTOMS SPHERE

JULY 2018

Business OMBUDSMAN Council

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LIST OF ABBREVIATIONS

Abbreviations	Definition
AEO	Authorized Economic Operator
Association Agreement	Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part.
CAO	Code on Administrative Offenses of Ukraine
CCU	Customs Code of Ukraine
CrCU	Criminal Code of Ukraine
CMU	Cabinet of Ministers of Ukraine
Directive No. 2013/0432/ COD (Proposal)	Proposal for a Directive of the European Parliament and of the Council dated 13 December 2013 No.2013/0432/COD "On the Union legal framework for customs infringements and sanctions". (please follow the link: https://eur-lex.europa.eu/procedure/EN/2013_432)
ECJ	European Court of Justice
EFTA	European Association of Free Trade
EU	European Union
EU Customs Code	Regulation (EU) No.952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (revised version) (please follow the link: https://eur-lex.europa.eu/procedure/EN/2013_432)
HACU	Higher Administrative Court of Ukraine
IPR	Intellectual property rights
Ministry of Economy	Ministry of Economic Development and Trade of Ukraine
Ministry of Finance	Ministry of Finance of Ukraine
Procedure No. 618	Procedure for refund of funds accounted for on the accounts of the customs authority in the form of prepayments; as well as refund of customs and other payments that are erroneously and / or excessively paid to the budget, approved by the Order of the State Customs Service of Ukraine, No.618 dated July 20, 2007, as amended
Procedure No. 643	Procedure for refund of advance payments (prepayment) and erroneously and/ or excessively paid customs duties amounts approved by the order of the Ministry of Finance of Ukraine No. 643 dated July 18, 2017
Procedure No. 648	Procedure for registration in the customs register of objects of intellectual property rights, which are protected in accordance with the law, approved by the Order of the Ministry of Finance of Ukraine dated 30 May 2012, No.648.

Abbreviations	Definition
SCU	Supreme Court of Ukraine
SFS	State Fiscal Service
SFS Statistics	Statistics provided by the State Fiscal Service of Ukraine in its' letter dated 20/06/2018 (out. No. 21154/6/99-99-19-02-01-15) issued in response to the Council's letter dated 08/05/2018 (out. No. 12459)
Regulation №608/2013	Regulation of the European Parliament and of the Council concerning customs enforcement of intellectual property rights
SSU	State Security Service of Ukraine
TRIPS	The Agreement on Trade-Related Aspects of Intellectual Property Rights, which has been adopted in the course of Uruguay Round of the General Agreement on Tariffs and Trade (GATT) in 1994.
TFA	Trade facilitation agreement, that is a part of the Marrakesh Agreement establishing the World Trade Organization (included to the Annex 1A of the WTo Agreement according to the Minutes on amending the Marrakesh Agreement establishing the World Trade Organization dated 27 November 2014 in Geneva), which entered into the force on 22 February 2017 after its ratification by 110 countries-members of the WTO, including Ukraine (the Law of Ukraine dated 04 November 205 No. 745-VIII).
UCGFEA	Ukrainian Classification of Goods for Foreign Economic Activity
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization

1 FOREWORD

This systemic report of the Business Ombudsman Council (the **"Council"**) focuses on analysis of the main problems currently faced by business in the customs sphere (the **"Report"**).

The customs is known to be one of the key contact points between the State and business. Hence, efficiency of customs procedures plays key role in methodology employed to rank countries in many international rankings. As such, as far as countries' international image in the area of trade and investment is concerned, significance of this sphere is difficult to overestimate.

The significance of the matter is evidenced, inter alia, by the fact that from May 2015 until July 2018 the Council received **150 complaints** challenging actions or inactions of the customs authorities. Although the taxonomy of issues lodged for the Council's consideration is rather broad, the most common ones comprise delay/ denial of customs clearance (50 complaints); customs value determination (42 complaints) as well as refund of excessively paid customs duties and fees (13 complaints).

From geographical standpoint, the largest number of complaints were lodged to challenge actions and inactions of Kyiv Customs of SFS (36 complaints) as well as Dnipropetrovsk and Odesa Customs of SFS (17 and 13 complaints, respectively). In addition, a certain number of complaints have been lodged on Lviv Customs of SFS (7 complaints); 6 complaints have been received in respect of Volyn and Sumy Customs of SFS; 5 and 4 complaints – Mykolaiv and Zakarpattya Customs of SFS respectively and other Customs.

The Report commences with the section comprising **analysis of the problems faced by business the customs sphere**, which are the most pressing for business nowadays. The range of such issues has been determined based on both the analysis of complaints lodged with the Council as well as general review of the situation in this sphere taking into account outcomes of comprehensive consultations held with key experts and leading business associations.

First of all, the Report pays considerable attention to issues related to **determination of customs value** by focusing on deficiencies of its controlling mechanism (including groundless requests to disclose documents; often non-systemic and non-transparent use of control methods, etc.). Having critically analyzed these issues, the Council issued a number of recommendations, including to the Ministry of Finance of Ukraine (the **"Ministry of Finance"**): (i) to prepare draft amendments to the Code of Ukraine on Administrative Offenses (the **"CAO"**) foreseeing administrative liability of officers (officials) of customs authorities for violations of customs legislation; (ii) to develop and publish (by following approach employed in the UK) a comprehensive guideline specifying

[1] The leading ratings data shows that, despite certain progress made in recent years, there is still a need to improve certain customs processes in Ukraine.

In particular, according to the World Economic Forum's Global Competitiveness Index 2017-2018, Ukraine ranked 126th among 137 countries by "Burden of Customs Procedures" indicator.

In the World Bank's Doing Business 2018 rating by "Trade across borders indicator", which, in particular, studies time and financial costs for exports and imports, Ukraine ranks 119th out of 190 countries.

In the Index of Economic Freedom 2018 rating, annually compiled by the American Heritage Foundation, according to "Trade Freedom" index, measuring tariff and non-tariff barriers that affect imports and exports, including customs barriers, Ukraine ranked 74th out of 180 countries.

procedures for declaration and control of customs value; and (iii) to amend secondary legislation to enable submitting to the customs all documents (copies thereof) in electronic form.

Besides, within this part, the Report addresses **ineffective regulation of the financial guarantees**, – matter adjacent to the field of customs value's determination. The Council's recommendations in this sphere suggest developing amendments to several provisions of the Customs Code of Ukraine (the **"CCU"**) aimed at transforming this mechanism into truly effective tool for facilitating import operations, which could be employed by business in disputes with the customs to ensure release of goods for free circulation without paying additional customs duties until the dispute is settled.

We then concentrate on the issue of **refund of excessively paid customs duties and fees**. Although some progress in this sphere is noticeable, the recommendations to fully resolve this issue are as follows: (i) the State Fiscal Service (the **"SFS"**) – to update an existing explanation letter; and (ii) the Ministry of Finance – to amend the subordinate legislative act governing the foregoing issues to prevent the situation when declarants have to re-apply to courts (after the court had already decided on the merits of the dispute) to urge the State to refund customs duties and fees.

The Report continues with a section containing a comprehensive analysis of issues in the field of **classification of goods**. Here emphasis is placed, *inter alia*, on the inconsistency of practical enforcement of laws and regulations as well as the failure of customs authorities to take into account positions of courts. Hence, the set of recommendations is as follows: (i) the Ministry of Finance and the SFS – to create a public register of decisions on classification of goods based on the approach employed in the European Union (the **"EU"**); (ii) the SFS – to issue operational guidelines to ensure proper consideration of existing judicial practice by customs authorities; (iii) the Ministry of Finance – to develop a draft law that would ensure impossibility of prosecuting for genuine errors made while defining code under the Ukrainian Classification of Goods for Foreign Economic Activity (the **"UCGFEA"**); and (iv) the Ministry of Finance and the SFS – to prepare and conduct educational training programs for SFS employees to ensure proper reasoning of classification decisions.

Thereafter we address such an urging issue as **an administrative liability for infringing customs rules**. Since liability for some infringements is currently unbalanced and disproportionate vis-à-vis gravity of violations, – thus affecting not only business interests but also international obligations of Ukraine, – the Council recommends developing amendments to the CCU to ensure its approximation to the leading practices employed in the EU.

The next chapter is devoted to the issue of unjustified **intrusion of law enforcers into customs review (examination) procedure**. Given negative impact of such a practice on business environment in Ukraine, the Council's main recommendation is to the Ministry of Finance and the SFS (in cooperation with key law enforcement authorities) to develop and approve an inter-agency instruction setting forth clear and transparent mechanism of institutional interaction. The Council also recommends preparing draft law, which would remove from the CCU provisions enabling law enforcement authorities to initiate customs examinations.

The section completes with the analysis of the **protection of intellectual property rights (the – "IPR") while transferring goods across customs border of Ukraine**, which was examined by the Council from the standpoint of bringing Ukrainian legislation in compliance with the requirements and standards employed in the EU. Here the Council elaborated set of respective recommendations, proposing, inter alia (i) to develop and adopt primary legislation, which would improve procedures of facilitating IPR's protection at the part of the customs authorities to be done, inter alia, in accordance with the Regulation (EC) No. 608/2013; as well as (ii) to create the IPR Competence Center at the SFS,

as provided by the EU Customs Blueprints. As Ukraine is currently in the process of large-scale reforms in the field of administering customs, the next section of the Report is devoted to reviewing **strategic areas of reforming this sphere**. At the beginning of the section, the Council praises recent adoption by Verkhovna Rada of the Draft Law No. 7010 aimed at implementing such a progressive mechanism as "single window" at the customs.

We then continue by analyzing perspectives of implementation of an **Authorized Economic Operators** (the – **"AEO"**) – mechanism developed in the EU and long-awaited in Ukraine. The recommendation is to ensure prompt adoption of the relevant draft law. In addition, the Ministry of Finance is recommended to adopt legislative act, which would establish the possibility to temporarily engage foreign specialists to train local personnel and actually conduct audits, required for granting AEO status.

Finally, the Report focuses on the problems of a switch to **post-clearance audit procedures as a primary form of customs control**. The Ministry of Finance and the SFS are recommended to ensure a gradual transition of customs value control to post-clearance audit stage, save for instances when an objective comprehensive risk assessment system alerts about the need to conduct control during customs clearance stage. The Council also provides a number of recommendations aimed at ensuring publication of information related to post-clearance audit control implementation.

* * *

It is worth noting that the **Report does not cover each and every issue pertaining to the customs sphere in Ukraine**. In particular, without diminishing the significance of the ongoing discussion on the *institutional reform of the SFS* (particularly, in so far as it contemplates spinning off customs administration into independent state authority), the Council did not address this topic in the Report, whose primary focus is on problems arising in course

[2] *See* Draft Law of Ukraine "On Introducing Amendments to the Customs Code of Ukraine and Certain Other Legislative Acts of Ukraine Regarding Introduction of a "Single Window" Mechanism and Optimization of Control Procedures When Transferring Goods Across Customs Border of Ukraine" No.7010, dated July 27, 2017.

of interaction between business and customs authorities.

In view of the recent adoption of the Draft Law of Ukraine No. 7010[2], the Report also did not cover the functioning of a "*singe window*". Here we presumed that this important reform is being duly advanced and for the time being does not require additional recommendations from the Council.

Most aspects of the implementation of the Convention on a common transit procedure[3] (*including the issue of the European Customs Transit System (NCTS) application*) as well as safety and security matters arising at the border have also not been captured by the Report. Finally, the Report does not cover specific issues inherently falling beyond the scope of the customs sphere, raised by selected experts during work on the Report. In particular, this relates to certain *restrictions and deficiencies in regulatory framework in the field of foreign economic activity and currency control*[4].

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3 Convention on a common transit procedure (EU OJ L 226, 13.8.1987, p. 1).

4 In particular, some experts mentioned: (i) legislative provisions prescribing mandatory execution of a foreign economic agreement in the form of a single written document (which does not correspond to the modern business practices and creates additional paper load, particularly during customs clearance); and (ii) burdensome currency control restrictions, which, inter alia, make it commercially unfeasible to employ "customs warehouse" regime.

2 OVERVIEW OF THE MAIN PROBLEMS IN CUSTOMS SPHERE

Majority of customs related complaints lodged with the Council pertained to such issues as determination of the customs value and classification of goods as well as the issue of refund of excessively paid customs duties and fees deriving therefrom. All of these issues incorporate such themes as inconsistency and non-transparency of the activity of customs authorities; lack of the adequate mechanisms for bringing officials of customs authorities to liability for illicit actions and inflicting damages; as well as excessive inclination of the customs authorities towards fiscal rather than controlling or servicing function.

Indeed, the one may observe tendency whereby decisions issued by custom authorities are driven by volumes of planned budgetary revenues rather than by merits of a particular case. Such conditions distort functionality of customs authorities as control over customs value's determination focuses on finding grounds for its' (sometimes artificial) increase. Similarly, qualification decisions are adopted in anticipation of positive consequences for the budget (caused by the change of the classification of goods) rather than on how well-grounded is the given approach to classification. Even refund of excessively paid customs duties and fees is being sometimes delayed due to perception that it leads to losses for the budget.

Recent statistical data (which, by the way, is being regularly disclosed by customs authorities to prove their efficiency) demonstrate that revenues from customs procedures constitute one of the core sources of the budget's income part[5]. This fact, – together with significant number of customs disputes that are currently being adjudicated, – evidently demonstrates shifting of functionality of customs authorities towards fiscal one. Yet, the best international practices contemplate departure from prevalence of fiscal approach by balancing it with controlling and servicing ones.

In addition to this aspect (which triggers the whole range of issues, described in more details below) the business also challenges groundless intrusions of the law enforcement authorities into customs examination procedure, which leads to significant delays with completion of customs clearance procedures.

Another matter deserving attention is liability for breach of customs rules – area known to be criticized by both business and expert communities due to mismatch between severity of sanction and gravity of infringement committed.

Last but not least, the Council is aware about existence of several controversial issues pertaining to the protection of intellectual property rights while transferring goods via customs border of Ukraine.

Hence, the following sections comprise more detailed analysis of each of the foregoing problems and issues known to be faced by business in customs sphere, including Council's recommendations aimed at their resolution.

[5] In particular, according to the Report about fulfillment of the State Budget of Ukraine for 2017, customs fees and VAT charged for import of goods constituted some 33% of the annual tax revenues and approximately 27% of all revenues of the State budget. However, since import VAT is subsequently being accounted by the importers as their tax credit (which decreases amount of VAT calculated for payment upon the end of the respective tax period), – it might be presumed that, as far as actual financing of the State budget is concerned, the significance of these funds is, in all likelihood, quite nominal.

2.1 Determination of customs value

The Council is well aware that vast majority of criticism extended to customs authorities relates to inefficient and non-transparent nature the control procedures employed in course of determination of customs value, comprising a basis for calculating customs payments to be paid due to transferring goods across the customs border of Ukraine.

The following concentrates on such key aspects of this problem as: (i) deficiencies while exercising control over customs value's accurate determination; and (ii) inefficient legal framework governing use of financial guarantees.

2.1.1 Deficiencies While Exercising Control Over Customs Value's Accurate Determination

From the Council's perspective, the weakest point of control over customs value accurate determination is the lack of sufficient predictability and transparency in each single action of the customs authorities. It leads to the lack of much needed consistency when it comes to both the substance of decisions rendered by customs authorities as well as position of courts vis-à-vis matters that are being adjudicated upon challenging decisions on readjustment of customs value.

The following analysis of this issue is focused on such aspects in the activity of customs authorities as (a) abuse of the right to request additional documents; (b) non-transparent application of secondary customs valuation methods; and (c) adding non-existent payments to customs value's calculation.

(a) Abuse of the right to request additional documents

The Council is well aware of not infrequent cases when declared customs value is subjected to thorough control at the part of customs authorities, with the latter tending to abuse their right to request additional documents.

In particular, documents not foreseen by the exhaustive list set forth in Article 53 of the CCU might be requested. Besides, the customs authorities not always adhere to the requirements regarding the grounds for requesting additional documents set forth in the CCU.[6] In some instances, a request to disclose additional documents might not contain any justification of its' grounds whatsoever.

Moreover, not always discrepancies, found in documents attached to the customs declaration, appears to bear such a substantial significance that they could have affected the accuracy of customs value's determination.

As a result, declarants suffer from the fact that providing customs authorities with the documents requested frequently leads to delays in customs clearance.

[6] These are either discrepancies in documents attached to customs declaration for confirmation of customs value; existence of signs of forgery or lack of data confirming the numerical values of constituting elements of customs value of goods; or information on the price that have actually been paid or is due to be paid for these goods. *See* Paragraph 3 of Article 53 of the CCU.

Case No. 1. Groundless request of documents

In February 2017, the Council has been approached by a distributor of fish and seafood ("**the Complainant**"). According to the Complainant, Mykolaiv Customs had unreasonably increased customs value of the goods they were importing. In order to confirm the price of goods for the customs authority, the importer prepared an exhaustive package of documents. As required by the law, the Complainant enclosed the sale and purchase agreement to the mentioned package – a document comprising a basis for the first method customs valuation.

Under the general rule, the price is supposed to be determined using other methods only when it is impossible to determine it based on the terms of the respective contract. Nevertheless, Mykolaiv Customs did not approve the price specified in the contract. Instead, it suggested a value, higher by early 10%, which had been calculated by the customs authorities based on similar contracts.

In course of the complaint's investigation, the Council's investigator participated in consideration of the Complainant's appeal at the SFS and supported the Complainant's position. The Council's investigator, inter alia, drew the attention of the SFS to irrelevance of the argument of customs authorities regarding lack of a certified copy of the customs declaration issued by the country of origin.

With the assistance of the Council, in May 2017, the Complainant reported that the SFS agreed the customs value of goods declared by the Complainant.

To solve the problem of groundless requests for documents from a declarant by customs authorities, the Council suggests a comprehensive approach comprising the following elements: (i) to shorten the list of grounds for requesting additional documents from a declarant; (ii) to improve the mechanism of bringing officials of customs authorities to liability; and (iii) to ensure that communication between subjects of customs procedures and customs authorities is conducted in an electronic form.

(i) Shortening the list of grounds for requesting additional documents

The Council is mindful that to resolve the foregoing problem, the Draft Law of Ukraine No. 4777[7] contemplates expanding words "... *containing discrepancies*" contained in Article 53 of the CCU by incorporating thereunder words "... *fundamentally affecting accuracy of customs valuation.*" In other words, it is proposed that only those discrepancies that justify subsequent re-adjustment of customs value may constitute a legitimate ground for customs authority to lodge a request seeking disclosure of additional documents by a declarant. This proposal appears to the Council as quite reasonable to justify actions of customs authorities that may significantly affect the course of customs clearance procedure.

Besides, it also worth taking into account legal position of judicial authorities stating that a customs authority shall properly specify to a declarant (or its authorized representative) which particular information needs to be clarified.[8] Thus, while generalizing the practice of applying provisions of legislation on customs valuation, the Higher Administrative Court of Ukraine (the **"HACU"**) concluded that a customs authority should create conditions, which would enable a declarant to exercise the right to provide additional data to a customs authority, if needed.

(ii) Improving the mechanism of bringing officials of customs authorities to liability

Currently, the law provides no mechanism which would enable application of Article 30 of the CCU establishing liability of fiscal authorities, their officials and other employees for their illicit actions or inactions, including those committed for their personal benefit or for the benefit of third parties.

As for the mechanism of disciplinary liability, since the respective powers are vested with the SFS (i.e., since officials of the customs authorities are subordinated thereto), – there is a risk of the lack of objective approach if such matters are to be resolved internally within effectively one body (authority).

Hence, in order to improve practical implementation of the mechanism of bringing officials of customs authorities to liability, it appears that it should be more appropriate to focus on administrative liability of the officials of customs authorities rather than disciplinary one. In the Council's view, such an approach is indeed more suitable from the standpoint of fulfilling preventive and corrective functions of legal liability as such.

It, therefore, seems to be reasonable to grant the power to issue protocols about violations of customs law to an authority beyond the SFS vertical structure. In particular, the authority to issue protocols about administrative violations committed by the officials of the customs authorities might, for instance, be vested with the State Regulatory Service of Ukraine, – body responsible for implementation of the state regulatory policy.

[7] *See* Draft Law of Ukraine "*On introducing amendments to the CCU regarding an authorized economic operator and simplifications of customs formalities*" No.4777 dated March 6, 2016.

[8] *See* Resolution of the Plenum of the HACU "*On Statement Regarding Generalization of Applying Provisions of the Customs Code of Ukraine by Administrative Courts in the wording dated March 13, 2012*", dated March 13, 2017 № 2.

(iii) Digitizing communication between participants of customs procedures

In the Council's view, another path towards improving efficiency of customs authorities in course of customs clearance may be shifting communication between participants of customs procedures to an electronic format.

The Council is aware that to the certain extent such electronic communication is already functioning. Nonetheless, it is known that customs authorities do not always agree with such approach to communication, by either referring to the risk of forging the electronic copy of a particular document or arguing that scanned copies of original documents are not "electronic documents" in the meaning of the Law of Ukraine "*On Electronic Documents and Electronic Documents Flow*".

Meanwhile, one of the most suitable examples of effective electronic communication between the SFS and taxpayers is the existing information and telecommunication system "*E-Cabinet*" (commonly referred to as "the Taxpayer's Electronic Office"). Here, exchange of electronic documents is being conducted by creating a new electronic document in a free form, by attaching thereto scanned copies of the necessary original documents and by certifying such a document with the use of taxpayer's electronic digital signature.[9]

From the Council's perspective, implementing similar system in customs sphere or introducing the possibility for customs authorities and other participants of customs procedures to exchange documents in electronic form (certified by an electronic digital signature with scanned copies of corresponding originals attached thereto), – would be a definite step forward towards ensuring efficient communication.

(b) Non-transparent use of secondary methods of customs value determination

It is known that each subsequent method of customs valuation is applicable only if customs value of goods may not be determined by applying the previous one.[10] For instance, in 2017, customs clearance based upon the first (basic) method comprised 90.7 % of all imported goods. This figure for Q1/2018 is reportedly 91.4%.

Yet, while making decisions on readjustment of customs value, customs authorities apply such secondary methods of customs valuation as contractual price for identical or similar goods; as well as a method based on deduction/addition of value and a fallback method. Meanwhile, the Council is aware that currently no sources of secondary legislation, operational guidelines or any other documents of institutional nature actually determine algorithm (sequence) of customs authorities' actions while exercising control over accuracy of customs valuation by applying secondary methods of customs value's determination. Therefore, the practice of applying secondary methods for customs value's determination is neither consistent nor sufficiently transparent.

As a consequence, in such circumstances declarants do not have clear information about actions of customs authorities that resulted in conclusion that declared customs value was inaccurate. This undermines efficiency of procedures employed to challenge decisions on customs value's readjustment and demonstrates than controlling procedures at the customs are not transparent.

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[9] *See* Order of the Ministry of Finance of Ukraine "*On Adoption of the Procedure for Operation of Electronic Office*" No. 637, dated July 14, 2017.

[10] *See* Para. 3 of Article 57 of the CCU.

Case No. 2. Insufficient justification of a conclusion

In January 2018, the Council received a complaint from Urtekstorg LLC (**"the Complainant"**) to challenge the decision on readjustment of the customs value of goods by Rivne Customs of the SFS.

Upon the request of Rivne Customs, the Complainant submitted the documents needed in order to confirm the customs value of goods declared, namely, the bank payment order and the expert report on qualitative and value characteristics of the goods issued by Rivne Chamber of Commerce and Industry. However, the customs authority indicated that the expert's conclusion provided by the Complainant does not constitute a ground for reviewing the decision on readjustment of the customs value of goods.

The Council, having supported legal position of the Complainant, sent a written request to the SFS asking for a full, comprehensive and impartial consideration of the complaint against the decision of Rivne Customs on readjustment of the customs value of goods.

In late January 2018, the Council recommended Rivne Customs of the SFS to review the decision on readjustment of customs value taking into account conclusion issued by Rivne Chamber of Commerce and Industry.

The Council is currently monitoring implementation of this recommendation.

Apart from moving communication between a declarant and customs authorities into electronic format (as already mentioned in the previous section), in the Council's view, non-transparent application of secondary methods of customs value's determination may also be resolved by systematizing (aggregating) existing explanations on application of rules in this sphere.

Hence, taking into account experience of the United Kingdom[11], such systematization may be achieved if the SFS were to issue a comprehensive guidelines, which would clearly describe sequence of actions to be undertaken by the customs authorities while selecting correct method of customs value's determination, depending upon individual circumstances of each case.

(c) adding non-existing payments to customs value's calculation.

The Council is aware of numerous cases when payments that have, in reality, never occurred are being added by customs authorities to the declared customs value, – particularly, payments for insurance, shipment and packaging.

There are cases when terms and conditions of a foreign economic agreement envisage insurance of goods; however, the procedure of paying for such service is not sufficiently specified.

In such circumstances, the declared customs value of goods may include insurance payments made prior to the commencement of transferring goods across the customs border of Ukraine. Or else, the documents provided by

[11] *See* Notice 252: "*Valuation of imported goods for customs purposes, VAT and trade statistics*" at the following link: https://www.gov.uk/government/publications/notice-252-valuation-of-imported-goods-for-customs-purposes-vat-and-trade-statistics/notice-252-valuation-of-imported-goods-for-customs-purposes-vat-and-trade-statistics

a declarant may lack data identifying contractual party bearing shipment and packaging costs, thus forcing customs authorities to count such payments while checking accuracy of customs value's determination.

In the Council's view, the following approach appears to be reasonable here. Should, according to a declarant, insurance be absent, a declarant should not be obliged to prove this fact. Instead, a declarant shall confirm solely the facts related to expenses which, in its view, comprise elements of customs value of goods. However, if customs authority contend that insurance indeed took place (and, hence, insurance costs are due to be included to the customs value), the customs itself shall prove this fact.

The Council's vision of methodological solution of the foregoing issues is based on the example of some European countries, particularly, the United Kingdom. The latter specified the methods of control over accuracy of declared customs value by adopting comprehensive methodological recommendation, the so-called "Notice 252: valuation of imported goods for customs purposes, VAT and trade statistics".[12] This document provides the one with an opportunity to generate a relatively clear understanding of peculiarities of applying customs valuation methods, as well as to prevent a declarant from being approached by customs authorities with certain specific questions.

In Ukraine, such a document may be developed and adopted by the Ministry of Finance. On the one hand, it would not have a binding effect and introducing amendments thereto would not require adherence to any formal legislative procedure. On the other hand – once published – it would be an easily-accessible official document enabling all parties to customs procedures to be promptly informed about unified standards of the processes related to control over accuracy of custom value's determination.

[12] Ibid

THE COUNCIL'S RECOMMENDATIONS:

In order to solve the foregoing problems with inefficient and non-transparent nature of control over customs value's determination, the Council recommends the **Ministry of Finance of Ukraine**:

1. In cooperation with the **Ministry of Justice of Ukraine** – to develop a draft law on introducing amendments to the Code on Administrative Offenses of Ukraine by supplementing Chapter 12 of the Code on Administrative Offenses of Ukraine ("*Administrative Offenses in the Areas of Trade, Public Catering, Services, Finance and Entrepreneurship*") with an article to govern administrative liability of officers (officials) of customs authorities for violation of customs legislation, as well as to grant the power to issue protocols on such violations to the central executive authority tasked to implement the state regulatory policy, the policy on supervision (control) in the field of business activity, licensing and permit system in the field of business activity, as well as deregulation of business activity.

2. To develop and publish guidelines on procedures for declaring and controlling accuracy of customs value's determination, including specification of the main stages of interaction between declarant and customs authority, as well as their rights and obligations (following the model employed in the UK Notice 252). Such an interpretation should be posted on the State Fiscal Service of Ukraine website or other official public sources.

3. To develop and adopt an order, which would enable customs authorities and declarants to exchange documents issued in an electronic form (i.e., certified by declarants' or authorized representatives' electronic digital signature) with scanned copies of corresponding originals (if requested by customs authorities or provided by declarants' on their own initiative) attached thereto.

2.1.2 INEFFECTIVE REGULATION OF FINANCIAL GUARANTEES

Existence of a reliable system of granting financial guarantees securing payment of customs duties by subjects of foreign economic activity is an important precondition for both simplifying and enhancing efficiency of customs procedures.

Thus, according to common international practice, a financial guarantee shall cover non-declared or inaccurately declared goods included in a consignment or specified in a declaration in whose regard a guarantee is issued.[13]

Consequently (i) release of goods is not delayed if guarantee is issued to ensure collection of duties and taxes due to be paid; (ii) national legislation specifies instances requiring issuance of guarantees, including their form; (iii) the customs authorities shall determine total amount for which a guarantee is issued; and (iv) any party required to present a guarantee is allowed to select any form of a guarantee, provided that it is acceptable to the customs authorities.[14]

Meanwhile, due to a number of gaps in the Ukrainian legislation, efficiency of financial guarantees is quite low. Hence, the following comprises analysis of such key aspects of this problem as (a) validity period of financial guarantees; and (b) criteria for parties entitled to grant financial guarantees to secure payment of customs duties and fees.

(a) Validity period of financial guarantees

Under the general rule, should a declarant disagree with a decision on readjustment of the declared customs value of goods, the latter shall, upon a declarant's request, be released into free circulation, provided that customs duties are paid based on the declared customs value of such goods and securing payment of a difference (i.e., between the amount of customs duties calculated by a declarant and the one calculated by the customs) by issuing a guarantee.[15]

Notably, the foregoing provision vests a declarant (in case of its' disagreement with a decision on customs value's readjustment) with the right to postpone payment of a difference between customs payments calculated by it and the customs authority, thus enabling a declarant to subsequently challenge such a decision and abstain from paying a difference, provided that the dispute is ultimately resolved in court in a declarant's favor.

It should be noted, that customs law of Ukraine foresees two types of financial guarantees, namely: (1) financial guarantee issued in the form of a document comprising a guarantor's obligation to pay the respective amount of customs duties; and (2) a monetary pledge (deposit) transferred by a declarant (or its authorized representative), shipper or guarantor to customs authorities' bank account.[16]

Meanwhile, the Council is aware that the instrument of financial guarantees granted by guarantors in the form of a document is not widely employed in practice. It is evidenced

[13] *See* Paragraph 36 of the Preamble of the EU Customs Code.

[14] *See* Standards 5.1 – 5.3 of the International Convention on the Simplification and Harmonization of Customs Procedures of May 18, 1973.

[15] *See* Para. 7 of Article 55 of the CCU.

[16] *See* Para. 2 of Article 310 of the CCU.

by both quite small number of guarantors registered in accordance with the CCU as well as actual lack of demand for such an instrument of securing customs payments at the declarants' part.

In the Council's view, the main reason for this is caused by the fact that the validity period of guarantees issued in any form is restricted by 90 calendar days from the date of goods' release.[17]

In this regard, it is worth noting that statistics demonstrate average term of the appeal procedure to a higher customs authority to be 2-3 months. Moreover, according to the foregoing statistics, percentage of decisions on readjustment of customs value, which are subsequently challenged with court, is quite significant. For instance, as far as Kyiv Oblast is concerned, in 2017 some 52.8% of decisions on readjustment of customs value have been challenged in the court.

Furthermore, as average duration of procedure of appealing the disputable re-adjustment with administrative court lasts for at least one year, – the total length of time required to receive final decision regarding readjusted customs value definitely exceeds 90 days.

Thus, it appears that since the existing validity term for guarantees issued in the form of a document (constituting 90 calendar days from the date of goods' release) is less than those that are required for passing other procedural decisions related to customs value's determination, – it actually undermines the very core of such a guarantee, which is to postpone payment of customs duties.

Consequently, a declarant is forced to bear service and commission costs associated with ensuring validity of a guarantee. However, upon expiration of 90 calendar days, such expenses become unjustified, as the validity period has expired, and, in most cases, the decision on readjustment of customs value has not yet been cancelled.

Therefore, taking into account average terms required for challenging decisions on customs value's readjustment in courts, in the Council's view, the mechanism of granting financial guarantees issued in the form of a document would fulfill its regulatory potential and constitute a justified option for business provided that the term of its' validity is extended for at least one year. Hence, the Council suggests amending Paragraph 7 of Article 55 of the CCU to introduce exception for financial guarantees granted in the form of a document. Accordingly, the validity period of such guarantees should be restricted to at least one year by supplementing Article 312 of the CCU accordingly.

However, since extension of the validity period of respective guarantee depends upon peculiarities of challenging decisions on customs value's readjustment, the Council suggests limiting the validity period of guarantees granted in the form of a document by a condition obliging a declarant to claim its disagreement with a decision on customs value's readjustment within 120 days following adoption of a decision on customs value's adjustment.

It is worth noting, however, that challenging customs authority's decision on customs value's readjustment by a declarant will not, in all cases, result in cancellation of such a decision. Yet, even in case of a negative outcome for a declarant, transfer of the respective revenues to the state budget (i.e., corresponding to the outstanding amount of customs duties) would, in any case, be delayed for a considerable period of time due to existence of the financial guarantee and subsequent challenging of the decision on customs value's readjustment.

Therefore, effective regulation of the legal framework of financial guarantees issued in the form of a document, based on the approach contemplating extension of the period of their validity, might require making the State eligible to seek the respective financial compensation.

[17] *See* Para. 7 of Article 55 of the CCU.

(b) Eligibility criteria for parties entitled to grant financial guarantees

In the Council's view, eligibility criteria for persons entitled to provide financial guarantees to secure payment of customs duties currently set forth in the CCU, appears to be quite non-transparent and creating pre-conditions for corruption while going through the procedure for including guarantors into the respective registry.

A good evidence of this is the fact that in accordance with Article 314 of the CCU, as at February 2018, as little as four legal entities had the guarantor status.

Among others, such requirements to guarantors as availability of electronic system for accumulating and exchanging information with fiscal authorities (taking into account limited access to the relevant software) as well as mandatory presence of authorized representation at all checkpoints at the state border appears to be excessive and unreasonably restricting access of financial institutions to obtaining guarantor's status.

It is worth noting here that the Convention on a Common Transit Procedure EU/EFTA[18] , further specified by the Proposal of the European Commission[19], does not contain such strict eligibility criteria for parties seeking guarantor's status.

Therefore, existence of well-balanced eligibility criteria for obtaining guarantor's status constitutes, in the Council's view, an important trigger for establishing stable operation of financial guarantees mechanism, foreseen by the Section X of the CCU.

THE COUNCIL'S RECOMMENDATIONS:

In order to improve the mechanism of applying financial guarantees in the customs sphere, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine**: to prepare governmental draft Law of Ukraine introducing the following amendments to the Customs Code of Ukraine:

   1.1. To supplement Paragraph 7 of Article 55 of the Customs Code of Ukraine to ensure that the general rule stating that validity period of guarantees issued by guarantors pursuant to Section X of the Customs Code of Ukraine "*...shall not exceed 90 calendar days as of the date of the goods' release*" would not apply to financial guarantees issued in the form of a document.

   1.2. To supplement Article 312 of the Customs Code of Ukraine with the provision stating that the validity period of a financial guarantee issued in the form of a document shall not exceed 365 calendar days after release of goods, provided that within 120 calendar days, following adoption of decision on customs value's adjustment, a declarant would notify customs authority about its disagreement with such a decision.

   1.3. To amend Article 314 of the Customs Code of Ukraine in order to harmonize eligibility criteria for parties entitled to grant financial guarantees to secure payment of customs duties with the current European practices (particularly taking into account provisions of Article 27 and Article 28 of the Convention on a Common Transit Procedure EU/EFTA).

[18] *See* at the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A21987A0813%2801%29

[19] *See* at the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0133

2.2 Refund of excessively paid customs duties and fees

As mentioned above (*see* Section 2.1 of this Report), customs authorities quite frequently increase the customs value of goods comprising basis for calculation of the amount of customs duties and fees (VAT, levies). Decisions could also be made to assign the UCGFEA code of goods being different from the one specified by the declarant (for more details, *see* Section 2.3 of this Report), which might affect the application of a specific duty or its rate. There are also disputes between declarants and customs authorities regarding verification of the country of origin of goods, which could also result in application of duties that otherwise would not be applicable.

Despite disagreement with such decisions of the customs, the declarants, in most of the cases, have to comply with them and pay customs duties as determined by the customs, so that goods in question could be released into free circulation.

However, in many cases declarants later successfully challenge the relevant decisions of customs authorities within the framework of the administrative and/or judicial procedures. Then the issue about the refund of excessively paid customs charges and fees to declarants arises.

Since launch of its operations, the Council has received 13 complaints[20] from businesses challenging significant delays with refunding excessively paid customs charges and fees or denial to refund. Such number appears to be quite significant, given that businesses turn to the Council only when they didn't succeed in their own efforts to solve the problem in pre-trial manner.[21]

The SFS Statistics[22], unfortunately, does not make it possible to reliably assess the extent of this problem. Indeed, the SFS calculates only general amounts of refunded customs charges and fees (in 2016 – more than UAH 474,1 million; in 2017 – more than 618,7 million; in I quarter of 2018 – approximately 190,4 million) without breaking these figures further down to demonstrate both timeliness of refund and additional administrative and/or judicial procedures applied by an applicant in order to facilitate such a refund.

Court practice developed in Ukraine in such a way that administrative courts, – when cancelling the decision of the customs, which resulted in excessive payment of customs duties (on adjustment of customs value, determination of the UCGFEA code of goods, etc.) – at the same time tend not to incorporate to their decisions an explicit reference to obligation to collect excessively paid customs duties from the state budget in a plaintiff's favor. Such a claim, if lodged, would be considered premature. Although courts acknowledge that cancellation of customs authorities' decision should ultimately result

[20] 1 complaint – in 2015; 2 complaints – in 2016; 7 complaints were lodged in 2017; 2 complaints in Q1/2018; and 1 complaint in Q2/2018.

[21] Admittedly, this problem does not pertain to customs relations only. The Council regularly receives substantially very similar complaints to challenge delayed refund of other payments from the budget (VAT, corporate profit tax refund etc.).

[22] Unless otherwise is expressly specified, in the Report the Council used statistics provided by the State Fiscal Service of Ukraine in its' letter dated June 20, 2018 (out. No. 21154/6/99-99-19-02-01-15) issued in response to the Council's letter dated May 08, 2018 out. No. 12459 (**the "SFS Statistics"**).

[23] *See*, in particular, the Decisions of the Supreme Court of Ukraine dated April 15, 2014 in the case No. 21-21a14; dated November 12, 2014, in cases No. 21-201a14 and 21-202a14; paragraphs 35-37 of the HACU No. 2 dated March 13, 2017, "*On Generalization of the Practice of Application of Provisions of the Customs Code of Ukraine in the wording March 13, 2012 by Administrative Courts*".

in refund of overpaid sums to the declarant, it is nonetheless assumed that it should occur within the framework of the relevant administrative procedure[23].

According to this procedure[24] a declarant must apply to customs authorities for a refund of excessively paid customs duties. The customs, after considering such an application, should issue a so-called "conclusion" on the refund of funds and send it to the State Treasury Service of Ukraine.

In practice, customs authorities sometimes refuse issuing such conclusions based on purely formal grounds. For instance, such refusals could be reasoned by arguing that a court, – while cancelling a decision of the customs on adjustment of customs value or determination of the UCGFEA code of goods, – has not directly obliged anyone to refund excessively paid customs duties to a declarant.

As a result, declarants have to go to the court again with a claim seeking inactivity of the customs to be acknowledged unlawful and to oblige the latter to prepare and send the relevant conclusion to the State Treasury Service.

CASE No. 3. Failure to refund excessively paid customs duties

In July 2017 the BOC received a complaint lodged by a major international pharmaceutical company to challenge inactivity of the Kyiv Customs of the SFS. In particular, Kyiv Customs had delayed a refund of UAH 242,000 of customs duties excessively paid by the Complainant in the second half of 2016.

The Complainant tried to get the overpayment refunded through the court, and the Administrative Court ruled in the company's favor. Still, Kyiv Customs refused to make the refund, referring to the fact of initiation by the latter of the deadline renewal for lodging a cassation claim.

The Council sent a written inquiry to the Head of Kyiv Customs of the SFS, seeking enforcement of the court decision and refund of the overpaid sums to the Complainant. The investigator also raised the importer's case in the course of the Expert's Group meeting at the SFS.

The Council's recommendations issued to the Head of Kyiv Customs of the SFS were finally implemented in August 2017. The Complainant received a refund of excessively paid customs duties in full.

[24] *See* the Procedure for refund of advance payments (prepayment) and erroneously and/ or excessively paid customs duties amounts approved by the order of the Ministry of Finance of Ukraine No. 643 dated July 18, 2017 (**the "Procedure No.643"**).

CASE No.4. Delay with the refund of excessively paid customs duties to the trading company

In September 2017, the Council received a complaint from a company involved in wholesale trade of spare parts and accessories for motor vehicles.

In course of investigation it was ascertained that due to cancellation of the decision of Kyiv Customs of the SFS of Ukraine on adjusting the customs value of goods, a part of the Complainant's import duty, import fee, and VAT amounts became excessively paid.

In accordance with the law, the company approached the Kyiv Customs of the SFS with a request seeking refund of excessively paid sum. However, the latter delayed with undertaking actions needed to ensure refund of overpaid amount to the Complainant.

The Council recommended Kyiv Customs of the SFS to issue a conclusion on the refund of corresponding amounts of funds from the State Budget of Ukraine and to submit it for execution by the Main Department of the State Treasure Service of Ukraine.

Following Council's involvement in October 2017, Kyiv City Customs of the SFS finally issued a conclusion on the refund of excessively paid funds and transferred it to the Main Department of the State Treasury Service of Ukraine in Kyiv.

In August 2016, an attempt was made to solve this problem through a formal explanation letter issued by the SFS.[25] This explanation instructs customs authorities not to consider the received applications formally; and assess in each case, whether it is likely that the case could be resolved in the customs' favor if a declarant were to go to court again.

Experts interviewed by the Council noted some improvement after issuance of this explanation – namely, reduction in the number of cases where declarants have to apply to court again seeking refund of overpaid customs duties.

Nonetheless, it would be premature to deem the foregoing problem as being resolved. The existing explanation vests the customs with significant operational discretion and, hence, does not completely exclude the risk of abuse. Besides, the said explanatory document (not bearing the status of a legislative act) is not formally binding. Moreover, cases when such explanation letters gradually ceased to be used by SFS authorities in practice were not infrequent. The latter scenario may be facilitated, among other things, by the amendments introduced to the relevant piece of secondary legislation (as it is the case here). In particular, the Procedure No. 643 applies since September 26, 2017. Prior to that date the Procedure No. 618 had been in force[26].

It is worth noting that although the Procedure No. 643 brought in certain positive implications, it nonetheless contains provisions that can

[25] *See* SFS letter dated 08.04.2016 N 26593/7 / 99-99-19-01-01-17

[26] *See* the Procedure for refund of funds accounted for on the accounts of the customs authority in the form of prepayments; as well as refund of customs and other payments that are erroneously and / or excessively paid to the budget, approved by the Order of the State Customs Service of Ukraine, No.618 dated July 20, 2007, as amended (**the "Procedure No.618"**).

actually complicate the process of customs duties' refund. In particular, in the list of documents to be submitted to the customs for customs duties refund, a reference is made to: "*a court 's enforcement letter and/ or a decision, which has become effective (if available), authorizing refund of the relevant customs duties amounts.*" It is obvious that such wording corresponds only to a substance of a court decision, which may be issued in case of declarant's repeated application to court.

In general, the Council has not yet observed the tendency towards reduction in the number of complaints lodged to challenge failure to refund sums of excessively paid customs duties (7 complaints were received during 2017, 2 complaints – during I quarter of 2018).

THE COUNCIL'S RECOMMENDATIONS:

In order to facilitate systemic resolution of the issue of excessively paid customs duties and fees, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine** – to introduce amendments to the *Procedure for Refund of Advance Payments (Prepayment) and Erroneously and/or Excessively Paid Amounts of Customs Duties*, approved by the Order of the Ministry of Finance of Ukraine, dated July 18, 2017 No. 643, which would enable a declarant to attach to the application for refund of erroneously and/ or excessively paid customs duties amounts a court decision rendering illicit or acknowledging unlawful decision or actions at the part of SFS authorities that led to (resulted in, caused) erroneous and/or excessive payment of customs duties (i.e., as an alternative to enforcement letter issued by a court and/or a court decision authorizing refund of certain amount of customs duties).
2. **The State Fiscal Service of Ukraine** – to update the Explanation Letter, dated August 4, 2016 № 26593/7/ 99-99-19-01-01-17 or issue a new one or methodical recommendations for the customs to clarify the procedure for enforcing court decisions as well as decisions adopted within the framework of the administrative appeal procedure, approved in declarant's favor. Due attention should be paid to the need to take into account not only the operative but also the reasoning part of the court decisions on the merits of the dispute. If a court decision were to find decision or action of the customs authority that led to (resulted in, caused) payment of excessive amount of customs duties as being erroneous or false – to state that such a language constitutes sufficient ground to proceed with the refund of overpaid sums of customs duties without initiating an additional judicial procedure.

2.3 Classification of goods

Classification of goods for customs clearance comprises determination of digital code number for certain goods (ten digits in Ukraine). Classification determines, among other things, rate of customs duty, possibility to apply preferential VAT rates, eligibility to obtain import or export licenses, qualification of a good as excisable, etc.[27]

The UCGFEA is compiled based on the Harmonized Commodity Description and Coding System[28]. Nonetheless, although practical application of this coding system has a lot of examples – the appearance of new products, changes in their essential characteristics, inconsistencies in law enforcement practices amongst different countries, lead to numerous disputes on classification issues.

Following the adoption of the CCU in 2012, the duty to ensure correct classification of goods was mainly imposed on a declarant. Thus, release of goods into free circulation pursuant to a declarant's classification no longer means the approval of such classification by customs authority. Such an approach contemplates that control of customs authorities over correctness of calculated customs duties and fees is carried out during documentary audits conducted after release of goods into free circulation.

According to the information which was disclosed to the Council by the SFS, some 608 documentary inspections on compliance with the customs legislation of Ukraine has been held in 2017 (carried out within three years after the customs clearance of goods). Classification of goods comprised subject-matter of 282 inspections, reportedly resulting in imposition of additional monetary obligations in the amount of UAH 28.4 million. As for the Q1/2018 – 146 of such documentary inspections have been held, resulting in imposition of additional monetary obligations in the amount of UAH 12.5 million.

Thus, as disputes on classification of goods under the UCGFEA appears to be inevitable in many instances, introducing selected changes in this sphere may, in the Council's view, make relationships between business and customs authorities regarding classification more predictable. Hence, in this section, the Council concentrates on such aspects of this task as (i) consistency while enforcing laws and regulations; and (ii) procedures and forms of decisions on classification of goods.

2.3.1 Consistency while enforcing laws and regulations

There are cases when a customs authority, despite existing judicial practice or its own classification practice (*vis-à-vis* the same, identical or similar characteristics of goods) makes a decision that differs from it. In the Council's view, in such case decision of a customs authority should contain clear substantiation of the reasons justifying use of an approach short of being well-established. Besides, holding declarants liable in such a case seems excessive and contrary to the principle of legal certainty.

[27] *See* Section IV of the CCU No. 4495-VI dated March 13, 2012.

[28] *See* Harmonized Commodity Description and Coding System is an international nomenclature of goods developed by the World Customs Organization. More information at the following link: http://www.wcoomd.org/en/topics/nomenclature/overview/what-is-the-harmonized-system.aspx.

CASE No.5. Ignoring court decision issued with respect to an identical product

In February 2018, "TROUW NUTRITIOn UKRAINE" LLC (**the "Complainant"**) turned to the Council in connection with assignment of incorrect declaration of UCGFEA code followed by imposition of monetary obligations according to documentary off-sight audit of classification. The tax authority applied the sub-heading 2309 90 96 90 to the imported product (soy protein concentrate) instead of the sub-heading 2304 00 00 00 determined by the importer.

In course of the complaint's investigation the Council concurred with most of the Complainant's arguments. The Council drew special attention of the SFS to the fact that the Supreme Court[29] confirmed the correctness of classification of the same product under code 2304 00 00 00 in a case of another company (which also imported the same product).

Such conclusions of the Supreme Court should, in the Council's view, be regarded as binding on all government agencies, which in their practice apply a legislative act containing the respective provision.[30]

The Council recommended fiscal authorities to properly consider the complaint challenging decision on determination of the product code, by taking into account the Council's position and the Supreme Court's practice. Nonetheless, in May 2018, following its consideration, the taxpayer's complaint was left without satisfaction.

Indeed, it is unfair to apply sanctions when despite an error made regarding classification, all information used by the declarant to determine codes under the UCGFEA during customs clearance, was actually disclosed to customs authorities. Hence, fines and other sanctions for failure to pay customs duties and other violations identified in connection with incorrect classification of goods can be applied by customs authorities only if declarant submits false documents and/or provides them with false information (such an approach should extend to tax control as well).

In the Council's view, this could be attained by making it mandatory to take into account existing administrative practice on classification while adopting decision on classification of goods. Nonetheless, the actual decisions on classification of goods according to UCGFEA adopted by customs authorities within framework of results of documentary inspections on compliance with customs legislation of Ukraine (which are carried out within three years after the customs clearance of goods) are not currently issued or made public (only stated in the inspection report).

[29] The Supreme Court, which launched its' operations on December 15, 2017. The Ruling can be found at http://www.reyestr.court.gov.ua/Review/72551448.

[30] Pursuant to Article 13 (5) of the Law of Ukraine "*On the Judicial System and the Status of Judges*", No. 1402-VII dated June 02, 2016, conclusions on application of provisions, set forth in the decisions of the Supreme Court of Ukraine, are binding on all government agencies, which in their activity apply a legislative act containing relevant provision.

It also worth noting here that the European Court of Human Rights has already drawn attention[31] to violation by Ukraine of Article 1 of the Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms. In the respective case customs authorities assigned the same wrong code to the same imported goods, despite the number of national courts decisions cancelling respective decision of customs authorities.

2.3.2 PROCEDURE FOR DECISION-MAKING ON CLASSIFICATION OF GOODS. REASONING PART OF THE DECISION ON CLASSIFICATION. FORM OF THE DECISION IN A DOCUMENTARY INSPECTION REPORT.

As during tax control (documentary audits) decisions on classification is not issued in the form of a stand-alone document, it enables a supervisory authority to elaborate grounds for reclassification in rather arbitrary way, which, in the Council's opinion, is an unacceptable practice. Consequently, the lack of a clear procedure for decision-making on classification of goods and requirements to its reasoning part can create groundless barriers for businesses activities.

Accordingly, the reasoning part of the decision on classification of goods, in the Council's view, should contain explanations and arguments that would illustrate consistent application by a customs authority of the main rules of UCGFEA interpretation, set forth in the Law of Ukraine "On the Customs Tariff of Ukraine" No. 584-VII dated September 19, 2013 with following changes..

Besides, it is also evident that Ukraine's integration into the EU customs community is actually impossible without adhering to harmonized approaches when it comes to classification of goods. Hence, it is particularly controversial when the Ukrainian customs authorities apply classification of goods being different from the one regarded as correct by a certain EU country's customs authority.

Here it would be reasonable to take into account decisions of the European Court of Justice (the **"ECJ"**) having a rather extensive practice in the field of goods classification. As in matters related to classification of goods ECJ applies almost the same legislation as the one in Ukraine, – the ECJ's decisions can serve as an example for domestic practice of enforcing laws and regulations both in terms of reasoning part of decisions (procedure and approaches to enforcing main rules of interpretation) as well as in solving specific disputes related to classification of goods.

[31] Judgment of the European Court of Human Rights dated November 24, 2016, in the case of "*Polimerkonteyner TOV v. Ukraine*" (Application No. 23620/05).

CASE №.6. Deficiencies while charging additional payments under the framework of a documentary inspection

In December 2017 "Katena" LLC (the **"Complainant"**) turned to the Council in connection with the assignment of incorrect declaration code of UCGFEA followed by imposition of monetary obligations according to offsite scheduled documentary inspection of compliance with the requirements on state customs legislation.

In course of the complaint's investigation, the Council concluded that classification of goods performed by auditors was incorrect. Imported goods "*parts to a bulldozer: caterpillar thread, caterpillar link*" were classified under the product code 7315190000, while, according to the Complainant, the imported product should be classified according to 8431498000 code (as it was determined during clearance). The Council, referring to the Basic Rules of UCGFEA interpretation[32], drew attention to the fact that the Heading 8431 contains more specific description than Heading 7315 and, therefore, taking into account the requirements of the Rule 3 (a) of UCGFEA interpretation), the good, for the purposes of customs classification, should be assigned the Heading 8431.

The Council recommended the SFS authorities to conduct a full, comprehensive, and impartial consideration of the Complainant's appeal regarding relevant tax notifications-decisions. In March 2018, as a result of such a review, the SFS of Ukraine found that prior conclusions about wrong classification as being premature; tax notifications-decisions were canceled; and an unscheduled inspection on relevant issues was appointed.

In the Council's view, the erroneous/premature establishment of incorrectness of classification of goods in the Inspection Report occurred, *inter alia*, due to the lack of an appropriate decision-making procedure while determining the UCGFEA product code. The adoption of such a decision and its reflection in the relevant report based on inspection results without proper communication with the taxpayer (by providing the latter with the opportunity to explain its position and counterarguments *vis-à-vis* the SFS position) should be viewed as an obvious systemic deficiency.

[32] According to the General Rules of UCGFEA interpretation, in cases where under Rule 2 (b) or for any other reason, a good is prima facie classifiable under two or more headings, its classification is as follows: the heading which provides the most specific description shall be preferred to headings providing a more general description.

THE COUNCIL'S RECOMMENDATIONS:

To improve the practice of classification of goods for the purpose of their customs clearance, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine** and **the State Fiscal Service of Ukraine of Ukraine** – to ensure creation of a public electronic register of decisions on classification of goods, similar to practice employed in the EU. In the Council's view, not only decisions adopted by customs authorities during customs clearance should be entered into such a registry, but also those ones adopted by the State Fiscal Service authorities during documentary inspections and (for the sake of comprehensiveness of registry information) court decisions adjudicating correctness of the classification of goods.
2. **The State Fiscal Service of Ukraine** – to issue Methodological Recommendations to ensure proper consideration by customs authorities of the existing case law on classification according to the relevant Ukrainian Classification of Goods for Foreign Economic Activity codes. Among other things such a document would have to establish that while conducting classification of goods under UCGFEA having the same, identical or similar characteristics, due attention should be paid to practice generated by both domestic courts as well as by the European Court of Justice.
3. **The Ministry of Finance of Ukraine** – to prepare governmental Draft Law of Ukraine introducing amendments to Chapter 11 *"Liability" of Section II "Administering Taxes, Duties, Payments"* of the Tax Code of Ukraine and Chapter 67 "*General Provisions on Customs Offence and Liability for Them*" of Section XVIII "Customs Offence and Liability" of the Customs Code of Ukraine to eliminate the possibility of bringing individuals to liability if assignment of incorrect Ukrainian Classification of Goods for Foreign Economic Activity code resulted from actions conducted in good faith.
4. **The Ministry of Finance of Ukraine and the State Fiscal Service of Ukraine** – to prepare and conduct educational training programs for the personnel of the State Fiscal Service of Ukraine on reasoning decisions on classification of goods by using examples from the practice of the European Court of Justice. Such trainings should be public (to the extent possible) to disseminate a uniform understanding of issues pertaining to classification of goods.

[33] *See* European Binding Tariff Information (EBTI) at: http://ec.europa.eu/taxation_customs/dds2/ebti/ebti_consultation.jsp?Lang=en

2.4 Administrative liability for infringing customs rules

Ukraine is still in search of a balance in which effective protection of public interests and public order would be ensured without creating excessive pressure on the compliant business.

As almost in any sphere where business is facing state supervision, the issue of liability for infringing customs rules remains one of the most topical and controversial ones in customs sphere.

In particular, complaints lodged by businesses to challenge bringing them to liability for infringing customs rules (deemed to be groundless and excessive) are almost as frequent as complaints on ineffectiveness of the State while combatting such serious crimes as, for instance, organized smuggling.

Criminal prosecution for customs offenses has largely ceased to be a critical problem for business since the beginning of 2012, when decriminalization of smuggling took place.

Although restoration of criminal liability continues to be discussed publicly[34],[35] such initiatives have not yet been implemented. For the time being, the risk of criminal liability may occur only for illegal movement across the customs border of Ukraine in relation to certain categories of goods[36].

Hence, presently, the issue of administrative liability in customs sphere is more topical and worth to be focused on.

Unlike most administrative offences – whose substantive and procedural aspects are set forth in the CAO– infringements of customs rules and regulations are governed by the special rules set forth in the relevant sections of the CCU[37]. Hence, the CAO is applied only to issues not regulated by the CCU[38]. Contrary to administrative sanctions (penalties) having fixed thresholds whose level is largely insignificant, which are set forth in the CAO, fines for customs rules infringements, foreseen in the CCU, can be quite significant.

SFS Statistics concerning imposition of sanctions, prescribed by the CCU, shows that customs authorities are quite active in this field: in 2016 year they issued 12 839 orders on imposition of administrative sanctions in the total amount exceeding UAH 555,8 million; in 2017 – 21 652 orders in the total amount exceeding UAH 503,2 million; in I quarter of 2018 year – 8075 orders in the impressive total amount exceeding UAH 9,148 billion.

Furthermore, in accordance with Article 511 of the CCU customs authorities seized goods and vehicles: in 2016 year – in the total value of UAH 408,3 million; in 2017 – UAH 516,7 million; in I quarter of 2018 – UAH 80,7 million. The value of confiscated property, however, is considerably lower: in 2016 – UAH 177,9 million; in 2017 – UAH 157,4 million; in I quarter of 2018 year – UAH 38,6 million.

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34 *See* at the following link: http://zt.sfs.gov.ua/media-ark/news-ark/318648.html.

35 *See* at the following link: http://radako.com.ua/news/chi-mozhliva-kriminalna-vidpovidalnist-za-kontrabandu.

36 Historic and cultural values, poisonous, potent, radioactive or explosive substances, weapons and ammunition (except smoothbore hunting guns and ammunition thereto), and special equipment for surreptitious obtaining of information (Article 201 of the Criminal Code of Ukraine (**the "CrCU"**)); narcotics, psychotropic substances, their analogues or precursors, or counterfeit medicines (Article 305 of the CrCU); disks for laser reading systems, matrices, equipment and raw materials for their production (Article 203-1 of the CrCU); counterfeit money, public securities, state lottery tickets, excise labels or holographic protective elements (Article 199 of the CrCU); waste or secondary raw materials (Article 268 of the CrCU); certain works contradicting public order (Articles 300-301 of the CrCU), etc.

37 Section XVIII (material issues) and Section XIX (procedural issues).

38 *See* Article 487 of the CCU, Para. 4 of Article 2 of the COA.

From the perspective of SFS Statistics, persons, in whose respect administrative sanctions have been imposed, rarely employ administrative appeal procedure available in the SFS: in 2016 only 96 orders were challenged (9 appeals were not accepted into consideration due to the failure to meet deadlines or on other formal grounds; 59 were dismissed; 19 orders were cancelled and forwarded for new consideration; 9 were cancelled with closure of proceeding); in 2017 – 129 were challenged (8 appeals were not accepted into consideration; 100 dismissed; 11 orders were cancelled and forwarded for new consideration; 10 cancelled with closure of proceeding); in I quarter of 2018 – 32 orders challenged (8 appeals not accepted into consideration; 17 dismissed; 6 orders cancelled and forwarded for new consideration, 1 cancelled with subsequent closure of proceeding).

The foregoing statistics illustrating results of consideration of appeals in the SFS might be the key for ascertaining why administrative appeal procedure is not so popular. Indeed, only 7% of appeals resulted in clearly successful outcome for the appellant (i.e., complete cancellation of challenged order); whereas some 14% cases were returned by the SFS to the respective customs for further consideration; 68% of appeals were dismissed; and 10% were not accepted into consideration (rejected) on formal grounds.

By way of comparison, despite higher costs and procedural complexity of court procedure comparing with administrative one, it was reportedly employed 10 times more often (in 2016 year – 1110 orders were challenged to courts; in 2017 – 1229; in I quarter of 2018 – 33). The success rate of such procedure is considerably higher – at least 22% (330 orders cancelled by courts in 2016; 220 – in 2017; 33 – in I quarter of 2018; actual success rate, however, might be higher than the foregoing one, as considerable number of cases (pertaining to challenged orders which have not been cancelled yet) are still being considered by courts of various instances).

Moreover, courts obliged customs authorities to return seized property: in 2016 year – in the total amount of UAH 292,3 million; in 2017 – UAH 569,3 million; in I quarter of 2018 – in the amount of UAH 101,7 million. It appears that the foregoing statistics actually confirms position of those complainants that approached the Council alleging that groundless seizure of goods by customs authorities is not an infrequent phenomenon.

The need for reforms in this area arises from many international commitments of Ukraine. For instance, in the Association Agreement[39] the parties agree to set rules that would ensure that any penalties imposed for the breach of customs regulations or procedural requirements are proportionate and non-discriminatory and, in their application, do not result in unwarranted and unjustified delays.

The Association Agreement[40], *inter alia*, also binds Ukraine based on the principle of best endeavor to harmonize national legislation with the provisions of the EU Customs Code governing imposition of fines.

In its' turn, the current version of the EU Customs Code[41] establishes that penalties, imposed by each Member State for failure to comply with customs legislation, shall be effective, proportionate and dissuasive.

Here one should also take into account provisions of the Trade facilitation agreement (**the "TFA"**)[42] relating to penalties applied by the customs administration of a Member State. These provisions, in particular, specify that

[39] *See* sub Clause "l" of Clause 1of Article 76 of the Association Agreement.

[40] *See* Annex XV "Harmonization of Customs Legislation" with the Association Agreement" at the following link: https://www.kmu.gov.ua/storage/app/media/ugoda-pro-asociaciyu/15_Annexes.pdf).

[41] *See* Paragraph 1 of Article 42 of EU Customs Code.

[42] *See* Paragraph 3 of Article 6 of the TFA, in particular Clauses 3.3 and 3.5 (Ukraine committed to implement until December 31, 2020) at the following link: http://www.me.gov.ua/Documents/Detail?lang=uk-UA&id=70a47ec5-ab9d-49b3-94a0-7cd478023042&title=KategoriiVc.

the penalty imposed shall depend on the facts and circumstances of the case and shall be commensurate with the degree and severity of the breach. There are also requirements providing that decisions on imposition of fines have to be well-grounded.

In the context of Ukraine's anticipated international obligations, it is worth mentioning the Proposal for a Directive No. 2013/0432/COD, which is currently undergoing EU approval procedures. This document is intended to establish the EU legal framework for customs infringements and sanctions. It appears that it makes sense for Ukraine to take its provisions into account already now while improving its own legal framework.

The need for reforms in the area of administrative liability for infringement of customs rules in Ukraine has been confirmed by the experts interviewed by the Council and recognized by the competent authorities on more than one occasion[43]. Therefore, the Council presumes that the key point for discussion is not the need for reforms as such, but rather their directions and concrete steps. From that perspective, below we focus on such aspects of administrative liability for infringing customs rules as (i) adequacy of degree of liability; (ii) ascertaining subjective element (guilt); and (iii) subject of liability.

2.4.1 Adequacy of degree of administrative liability

The customs legislation of Ukraine currently foresees 18 administrative offences, the degree of liability for which varies significantly. Out of 18 offenses, 12 trigger imposition of fines in fixed amount (from 170 to 17 000 UAH); 4 – in the amount depending on the value of goods; 1 – depending on the amount of unpaid customs duties. In addition, 7 offenses provide for confiscation of goods and/or vehicles, which in 5 cases is an additional punishment, in 1 case – the main one, in the other one – an alternative.

These offences are mainly criticized by expert and business community for lack of fairness and for gravity of misconduct not being commensurate with the contemplated sanction.

For example, sanction set forth in one of the most widely used Article 483 of the CCU "*Movement or actions aimed at moving goods across the customs border of Ukraine in the manner being concealed from customs supervision*", – foresees confiscation of such goods and a fine in the amount of 100% of their cost (or 200% – in case of a repeated infringement). Yet, the title of this article does not correspond to its disposition, which is much broader and also covers submission of customs documents containing false information about the name of goods, their weight or quantity, the country of origin, the sender and/or the recipient, quantity of cargo items, their marking and numbers, false information required to determine

[43] See, particularly, the Action Plan for Customs Reform approved by the Ministry of Finance of Ukraine in July 2017.

the product code according to UCGFEA and its customs value. Therefore, the foregoing strict liability can threaten representatives of any declarants or customs brokers who provided customs with inaccurate information if this information is considered important by the customs for the purposes of customs control (notwithstanding the fact whether it was done intentionally, due to negligence, error, etc.).

For comparison, within the framework of unification of EU legislation in this field, it is proposed that penalties (in cases where the object of offence are goods) should not exceed: 30% of its cost in case of intentional breach; 15% of its cost – in case of gross negligence; 5% – in case of infringements that are punishable regardless existence of guilt (so-called "strict liability infringements" in the original language)[44].

In the Council's view, Ukraine should bring the degree of liability closer to these indicative figures.

2.4.2 Ascertaining subjective element (guilt)

Existence of guilt (intention or negligence) is a mandatory element of any administrative offence in Ukraine[45]. However, most of the CCU articles do not differentiate the degree of liability depending upon type of guilt (intention or negligence) actually occurred.

Yet, according to the approach that prevails in customs authorities' practical activities the existence of guilt is presumed and does not have to be proved – i.e., the absence of guilt can be subsequently proved in the court.

Moreover, despite the fact that the law actually refers existence of aggravating and attenuating circumstances[46], this provision is actually neglected as the CCU (unlike the CAO) establishes liability in a fixed amount rather than by setting its upper limit, thus eliminating discretion of customs officials and, to a large extent, even courts.

For comparison, unified EU legislation tends to divide infringement of customs rules into three categories: 1) punishable regardless existence of guilt ("*strict liability infringements*"); 2) those that require proving existence of negligence; and 3) those that require proving existence of intention[47].

Besides, in the EU the type and/ or degree of liability varies depending on such circumstances as seriousness and the duration of the infringement; the amount of the evaded import or export duty; the fact that the person responsible for the infringement is an authorized economic operator; the fact that the goods involved are subject to the prohibitions or restrictions or pose a risk to public security; the level of cooperation of the person responsible for the infringement with the competent authority; previous infringements by the person responsible for the infringement[48].

In the Council's view, it is advisable for Ukraine to adopt these best practices, namely:
i) to clearly establish the exact form of guilt (intention or negligence) as a mandatory element of each of the administrative offenses;
ii) to set the limits for each of the administrative offenses within which the liability may vary depending on aggravating or attenuating circumstances.

[44] *See* Proposal for a Directive No/ 2013/0432/COD (draft).

[45] *See* Article 458 of the CCU, Article 9 of the CAO.

[46] *See* Article 489 of the CCU, Article 33 – 35 of the CAO.

[47] *See* Articles 3-6 of the Proposal for a Directive No. 2013/0432/COD (draft).

[48] *See* Article 12 of the Proposal for a Directive No. 2013/0432/COD (draft).

2.4.3 AN INDIVIDUAL (OFFICIAL) AS THE SUBJECT OF LIABILITY

It is worth noting that the subject of liability for infringing customs rules in Ukraine (even in case of infringements committed during conduct of economic activities) is an individual (an official of business entity, as a rule, its director)[49].

Notably, there is a significant difference between the customs sphere and the tax one. In the latter case, the primary responsibility (in the form of financial penalties) lies solely with the taxpayer, a legal entity; while taxpayer's officials can be brought to either administrative liability (in a symbolic amount) or criminal liability from which they are exempted anyways if unpaid taxes (including penalties) would eventually be paid[50].

In the Council's view, the approach whereby only individuals (officials of legal entities) are regarded as subjects of administrative offences in the customs sphere (unlike tax and many others) appears to be quite doubtful. Moreover, European practice is also inclined towards liability of legal entities.[51]

It is worth mentioning that foreign (particularly European) companies are quite sensitive to risks that their top management can be brought to such a large degree of liability in Ukraine. It may be one of the reasons why they can be cautious about the prospect of acting as declarants at the Ukrainian customs; and if it is inevitable – as a rule, use the customs brokers services.

Hence, it is undoubtful that the present state of affairs is not a factor that positively influences perception of business environment in Ukraine as well as efficiency and transparency of customs procedures.

[49] *See* Para. 2 of Article 459 of the CCU.

[50] *See* Article 255 of the CAO, Article 212 of the CrCU.

[51] *See* Clause 11 of the Preamble and Article 8 of the Proposal for a Directive No. 2013/0432/COD (draft). In addition, in 15 out of 24 EU Member States (whose national legislation was researched during preparation of the said draft Proposal for a Directive) legal entities are subject to liability for customs infringements.

THE COUNCIL'S RECOMMENDATIONS:

In order to systemically resolve the foregoing problems in the sphere of administrative liability for infringing customs rules, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine** and **the State Fiscal Service of Ukraine** – to prepare text of the governmental Draft Law of Ukraine on introducing amendments to Sections XVIII "*Customs Offences and Liability*" and XIX "*Customs Offence Proceedings*" of the CCU (or setting forth these sections in the new wording) aimed at ensuring balance, commensurability and fairness of liability for customs infringements, taking into account best practices employed in the EU, in particular, Proposal for a Directive No. 2013/0432/COD (draft).

In particular, such Draft Law should provide for/contain:

a) financial liability for legal entities that infringed customs rules during their business activity, – to be introduced as an alternative to administrative liability of their officials (or with a significant softening of the latter);

b) reference to a specific form of guilt (intention or negligence) as a mandatory element of each administrative offence;

c) sufficiently specified list of aggravating and attenuating circumstances (including, *inter alia*, status of authorized economic operator; level of cooperation with the customs authority demonstrated in course of customs infringement's investigation, etc.);

d) lower and upper liability thresholds (in the form of the amounts of fines) for each article to make it possible to vary amount of fines depending on the circumstances of the case;

e) amounts of fines for infringing customs rules (which are established depending on the value of goods) to be brought in line with the indicative figures, specified in the Proposal for a Directive No. 2013/0432/COD (draft).

2.5 Intrusion of law enforcers into customs review procedure

The current CCU foresees that customs authorities may cooperate with law enforcement authorities in the manner prescribed by law.[52] Such interaction might be initiated either by customs authorities, – upon detecting within the course of customs procedures elements of committed crimes; or by law enforcers (in particular, the National Police and the State Security Service of Ukraine) (**the "SSU"**), – when it is necessary to interfere with the customs control procedure (mainly customs examination) within the framework of pre-trial investigation of criminal proceedings. In practice, in both instances, it might happen that diligent declarants fall under the law enforcer's scrutiny.

52 *See* Article 558 of the CCU.

53 *See* Part 2 of Article 325 of the CCU.

It is worth noting that law enforcers are vested with power to initiate quite broad range of actions implying direct access to a declarant's goods, such as their unloading, reloading, unpacking, packing, re-packing and weighting along with the determination of other substantial characteristics of goods subjected to customs clearance, including taking samples of such goods.[54]

Nonetheless, Paragraph 2 of Article 332 of the CCU expressly prohibits direct intrusion of law enforcers into customs examination procedure. Moreover, back in 2014 the SFS leadership warned management of customs about latter's personal responsibility for maintaining law and order in customs control zones.[55]

Despite this fact, groundless and lengthy customs examinations constitute main category of abuses in the "customs body – declarant – law enforcement authority" triangle, which businesses complain about.

The urgency of the problem is largely caused by the fact that customs examination procedure shares many common features with such investigatory action as search (which requires existence of ruling of investigatory judge). In fact, its main difference from search is that the former is being conducted in customs control zone. However, from a legal point of view, customs examination is a different procedure, which is not regulated by the Criminal Procedure Code of Ukraine and does not require existence of a ruling issued by an investigatory judge. This, in its turn, creates environment favorable for committing various abuses *vis-a-vis* business at the part of law enforcers, which, among other things, might bear corruption pretext.

As far as the Council's experience with complaints' investigation is concerned, we observe the following scenarios of abuse, comprising direct or indirect intrusion of law enforcers into customs review procedure:

1) Regular examinations carried out by customs authorities upon request received from law enforcement authorities, triggering groundless delays with customs clearance, including with respect to shelf-life goods.

2) Lack of acknowledgement in the customs inspection report that it was conducted in response to a request received from law enforcement authorities – as a result, a declarant does not have sufficient information on the reasons causing delay with customs clearance.

3) Unlawful direct or indirect intrusion of law enforcers into customs examination which is explicitly prohibited by Paragraph 2 of Article 332 of the CCU.

4) Reiterative taking of samples of goods by law enforcers after similar actions of the customs, thus triggering delay with customs clearance, including sending them to unaccredited expert institutions for examination.

5) The lack of a proper inter-agency communication and coordination leading to lengthy delays with customs clearance even after the grounds for it cease to exist (for instance, pre-trial investigation authority fails to inform customs authority in timely manner about closure of criminal proceeding).

[54] *See* Para. 1, 2 of Article 325 of the CCU.

[55] *See* the Letter of the SFS 17172/7/99-99-27-03-01-17 dated December 29, 2014.

Case No.7. Numerous retrieval of samples of goods

In November 2017, the Council received a complaint from a Ukrainian importer of soy lecithin against Lviv Customs of the SFS (**"The Complainant"**). The Complainant informed that he had been deprived of the opportunity to document two lots of imported goods (100 barrels of soy lecithin each) as customs officers as well as territorial unit of the SSU three times in a row took samples (from each lot) to perform laboratory tests to check the presence of genetically modified organisms (GMOs).

During customs procedure three samples against each of the two customs declarations were taken three times and three times sent to expert institutions for tests. However, none of the expert opinions found presence of GMOs in the goods that would exceed the allowed standards.

The Council sent written requests to L'viv Customs and the Department of SSU in L'viv Oblast. Circumstances mentioned in the complaint were also discussed with the aforementioned authorities' officials over the phone. As a result of such communication, both lots were allowed to pass the customs border. In December 2017, the case was successfully closed.

The Council is also aware that on June 20, 2018, the Cabinet of Ministers of Ukraine (**the "CMU"**) adopted the Resolution No. No.479 approving implementation of a pilot project (i.e., until December 31, 2018) aimed at creating conditions which would make it impossible to avoid paying customs duties (**the "Resolution No.479"**).

In particular, for the purpose of identifying facts of customs rules infringement the Resolution No.479 envisages that (1) police officers are entitled to be present round the-clock both in customs inspection zones, at the state border checkpoints and at other places within the customs territory of Ukraine where the SFS authorities perform customs formalities; as well as that (2) police officers and the Ministry of Internal Affairs personnel are granted with the right of access to "*Inspector-2006*" automated customs clearance system.

In the Council's view, however, given the lack of clear understanding of the mechanism of its' execution, implementation of the Resolution No.479 might only exacerbate the abovementioned problems with abuses committed by law enforcers in customs control zones. Besides, it appears that the Resolution No.479 contradicts with several provisions of the CCU, namely, Article 11 (regarding non-disclosure of confidential information by customs authorities) and Article 332 (prescribing non-interference of law enforcers into customs examination procedures).

Moreover, it is worth noting that in the field purported to be addressed by the Resolution No.479 there already exist rules set forth by the CCU. In particular, participation of law enforcers (while carrying out examination and re-examination of goods) is governed by the abovementioned provision of the CCU setting forth procedure of cooperation between customs and law enforcement authorities (Article 558 of the CCU) as well as the procedure of examination and re-examination of goods and transportation vehicles (Article 338 of the CCU). Besides, the relevant set of rules is already foreseen by (1) the Exhaustive List of Grounds, Whose Existence is Required to Carry Out Examination (Re-Examination) of Goods, Commercial Transportation Vehicles by Fiscal Authorities of Ukraine, approved by the Resolution of the CMU No.467, dated May 23, 2012; as well as by (2) the Procedure of Carrying Out Examination and Re-Examination of Goods, Commercial Transportation Vehicles, approved by the Order of the Ministry of Finance No.1316, dated December 12, 2012.[56] Therefore, mechanism of the Resolution No.479's implementation shall not contradict with the foregoing legislation.

Hence, in the Council's view, to tackle the problem of groundless intrusion into customs examination procedure at the part of the law enforcers, it is worth focusing on the following:

(1) To improve interaction between customs and law enforcement authorities by elaborating and approving the respective Inter-Agency Instruction, which would specify conditions of such an interaction in the manner which would exclude de facto participation of law enforcers in customs examinations by issuing instructions and/or assignments, which are treated by customs officials as binding;

(2) To develop and enforce the mechanism of implementation of the Resolution No.479, which would be compliant with the existing legislation, in particular, provisions of the CCU governing procedure of cooperation between customs and law enforcement authorities (Article 558 of the CCU), procedure of examination and re-examination of goods and transportation vehicles (Article 338 of the CCU) as well as provisions set forth in the acts of secondary legislation governing customs examinations and re-examinations;

(3) To narrow down powers of the law enforcement authorities to demand from the customs officials carrying out such actions with respect to declarant's goods as their unloading, reloading, unpacking, packing, re-packing, weighting along with the determination of other substantial characteristics of goods subjected to customs clearance, including taking samples of such goods;

56 *See* Section 4.2 of the Procedure of Carrying Out Examination and Re-Examination of Goods, Commercial Transportation Vehicles, approved by the Order of the Ministry of Finance of Ukraine No.1316, dated December 12, 2012; and Section 14 of the Exhaustive List of Grounds, Whose Existence is Required to Carry Out Examination (Re-Examination) of Goods, Commercial Transportation Vehicles by Fiscal Authorities of Ukraine, approved by the Resolution of the CMU No.467, dated May 23, 2012.

(4) To optimize criminal justice system in the sphere of combatting economic crimes, which would, inter alia, ensure removal of duplication of functions amongst law enforcement authorities and provide for the creation of the National Financial Security Bureau of Ukraine as the sole body with clearly specified powers and investigatory jurisdiction *vis-à-vis* crimes in economic, financial and tax spheres.[57]

THE COUNCIL'S RECOMMENDATIONS:

In order to minimize negative consequences for business arising from interference of law enforcement agencies in customs inspection procedure, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine**, **the State Fiscal Service of Ukraine**, **the Ministry of Internal Affairs of Ukraine**, **the State Security Service of Ukraine** – to elaborate and approve Inter-Agency Instruction on interaction of customs and law enforcement authorities. Such a document should, among other things, regulate (1) time limits for customs clearance, including liability (sanctions) for failure to observe such time limits; (2) restrictions with respect to the number of actions aimed at retrieving samples of the declarant's goods; (3) communication between customs and law enforcement agencies in the course of such interaction.
2. **The Ministry of Finance of Ukraine** – to develop and approve the mechanism for implementing the Resolution of the Cabinet of Ministers of Ukraine No. 479 "*On Realization of Experimental Project Aimed at Creating Conditions Making It Impossible to Avoid Paying Customs Duties and Fees*", dated June 20, 2018 to ensure compliance with (1) Articles 338 and 558 of the Customs Code of Ukraine; (2) the Resolution of the Cabinet of Ministers of Ukraine No.467, dated May 23, 2012 "*On Approval of the Exhaustive List of Grounds, Whose Existence is Required to Carry Out Examination (Re-Examination) of Goods, Commercial Transportation Vehicles by Fiscal Authorities of Ukraine*"; as well as (3) the Order of the Ministry of Finance of Ukraine No.1316, dated December 12, 2012 "*On Approval of the Procedure of Carrying Out Examination and Re-Examination of Goods, Commercial Transportation Vehicles*".
3. **The Ministry of Finance of Ukraine** and/or **the Ministry of Justice of Ukraine** in order to (1) place actions substantially similar to search outside the scope of customs examination procedure; and (2) narrow down powers of the law enforcers to demand from customs authorities carrying out such actions, – prepare governmental draft law on introducing amendments to Paragraph 2 Article 325 of the Customs Code of Ukraine to explicitly state that law enforcement authorities are not entitled to demand from persons that are transferring goods, commercial transportation vehicles through customs border of Ukraine carrying out operations, foreseen in paragraph one of this article (i.e., loading, unloading, reloading, fixing damaged packaging, unpacking, packing, re-packing, weighting along with the determination of other substantial characteristics of goods subjected to customs clearance, including taking samples of such goods, replacement of identification signs or marks on such goods or packaging thereto, commercial transportation vehicles as well as replacement of commercial transportation vehicles). Yet, such powers of the fiscal authorities shall remain in the effective wording of this article.

[57] *See* Draft Law of Ukraine No.8157 "*On the National Financial Security Bureau of Ukraine*", which was registered with the Verkhovna Rada of Ukraine on March 19, 2018.

2.6 Protection of intellectual property rights while transferring goods across customs border of Ukraine

Implementing measures aimed at ensuring due protection of IPR while transferring goods across customs border is a part of Ukraine's international commitments. In particular, this issue is mentioned in both the Agreement on Trade-Related Aspects of Intellectual Property Rights (**the "TRIPS"**)[58], adopted within the framework of the World Trade Organization (**the "WTO"**), as well as in the Association Agreement[59].

It is worth noting that these requirements are already partially implemented in the Ukrainian legislation[60]. In particular, there is the Customs Register of IPR objects[61] where total of 3779 objects were registered for the period from September 10, 2007 to July 9, 2018[62], including 405 objects in 2016; 291 object in 2017; 81 object in I quarter of 2018 year). In respect of IPR objects listed in the Customs Register there were 7139 cases of suspension of customs clearance of goods suspected in infringing IPR in 2016; 9692 cases – in 2017; 1560 cases – in I quarter 2018.

Nonetheless, the SFS Statistics shows that customs authorities appear to be quite reluctant to exercise other measures to combat IPR infringements. Indeed, a number of cases where customs clearance of goods has been suspended upon customs authorities' own initiative due to suspected infringement of IPR (as foreseen in Article 400 of the CCU) is reportedly low: only 16 cases in 2016; 77 cases in 2017; 0 cases in I quarter of 2018 year.

Administrative sanction for IPR infringements by customs declarants (Article 476 of the CCU) appears to be rarely enforced: only 17 protocols on administrative offences of this kind was issued in 2016; 14 protocols in 2017; and 4 protocols – in I quarter of 2018.

Procedure of simplified destruction of goods due to suspected IPR's infringement IPR (as opposed to the EU, where it was recognized "*having proved very successful*" by the European Parliament[63], and then made compulsory in case of presence of consent or tacit consent of owner of goods[64]) appears to be almost never employed in Ukraine (even though similar procedure is prescribed by Article 401 of the CCU): 4 cases in 2016; 1 case in 2017; none in I quarter of 2018.

In the Council's view, these figures prove the need to both (i) adopt EU approach in this sphere in Ukraine in more expedient manner; as well as (ii) strengthen the level

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58 *See* Articles 51 – 60 of the TRIPS.

59 *See* Article 250 of the Association Agreement.

60 *See*, in particular, Articles 397-403 of the Customs Code of Ukraine; Resolution of the Cabinet of Ministers of Ukraine No. 432 dated May 21, 2012 "*On Approval of the List of Grounds for Suspending Customs Clearance of Goods for which the Right Holder Has Not Given a Statement on Facilitation of His/Her IPR Object Proper Protection on the Customs Authority Initiative*"; the Order of the Ministry of Finance of Ukraine No. 647 dated May 30, 2012 "*On Approval of the Procedure for Interaction of Customs Structural Units When Exercising Customs Control and Customs Clearance of Goods Protected by IPR*"; the Order of the Ministry of Finance of Ukraine No 648 dated May 30, 2012 "*On Approval of Registration of IPR Objects Protected under the Law in the Customs Register*" (**the "Procedure No 648"**).

61 *See* the Procedure No. 648.

62 *See* at the following link: http://sfs.gov.ua/dovidniki--reestri-perelik/pereliki-/100237.html.

63 *See* the European Parliament Resolution of 18 December 2008 on the impact of counterfeiting on international trade (EU OJ C 45 E, 23.2.2010, p. 47.).

64 *See* Clause 16 of the Preamble and Articles 25-26 of the Regulation (EU) No 608/2013 dated 12/06/2013 of the European Parliament and of the Council regarding customs enforcement of intellectual property rights and Commission Implementing Regulation (EU OJ L 181, 29.6.2013, p. 15–34).

of competence of customs authorities in the field of IPR protection.

Meanwhile, the Association Agreement[65] requires that Ukraine, within three years from the date of its becoming effective[66], should implement two acts of the European legislation in this sphere, namely: Regulation (EC) No 608/2013 of the European Parliament and of the Council concerning customs enforcement of intellectual property rights[67] (hereinafter – **the "Regulation No. 608/2013"**); and Commission Implementing Regulation (EU) No. 1352/2013 establishing the forms provided for in the Regulation No 608/2013[68] (hereinafter – **"Regulation No. 1352/2013"**).

Among the requirements stemming from the foregoing acts of the EU legislation, the following ones worth particular mentioning:

1) bringing the definition of the "*goods infringing IPR*" in line with EU requirements, including exclusion of goods that are the subject of the so-called "parallel trade"[69] from the scope being covered by this concept;

2) establishing clear procedural terms, unified with EU requirements, to be followed by the customs and other interested parties within the procedure of suspending customs clearance of goods suspected of infringing IPR[70];

3) improving the regulation of the procedure for destruction of goods, whose customs clearance has been suspended on suspicion of violating IPR (including laying down the "*tacit consent*" principle for their destruction in the absence of objections from a declarant or owner of goods; and establishing a simplified procedure for the destruction of goods containing in small consignments)[71];

4) approving unified IPR protection measures related forms in accordance with EU standards.[72]

To the extent the Government of Ukraine has announced its plans to incorporate EU basic acts in the legislation of Ukraine in this sphere and established the terms of such implementation,[73] – presently, the deadline for implementation of the Regulations No.608/2013 and No.1352/2013 is the end of 2018[74], thus being ahead of schedule stipulated by the Association Agreement.

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65 *See* Annex XV to the Association Agreement.

66 The Association Agreement effective date is 01.09.2017, i.e. the above term expires on 01.09.2020.

67 *See* at the following link:: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0608&from=EN For reference: This Regulation was adopted as a substitution for Council Regulation (EC) No. 1383/2003 of July 2003 (mentioned in Annex XV to the Association Agreement) concerning customs action against goods suspected of infringing certain IPR and the measures to be taken against goods found to have infringed such rights as well as Commission Regulation (EC) No 1891/2004 of 21 October 2004 laying down provisions for implementation of the Council Regulation (EC) No 1383/2003 of July 2003.

68 *See* at the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1352&from=EN

69 *See* Clause 6 of the Preamble and Clauses 3-5 of Article 1 of Regulation No.608/2013.

70 *See* Articles 3, 7, 9, 11-12, 17-18, 23, 26 of the Regulation No.608/2013.

71 *See* Articles 25-26 of the Regulation No.608/2013.

72 Forms have been approved by Regulation No.1352/2013.

73 *See*, for instance, paragraphs 116 and 117 of the Action Plan on Implementation of the Association Agreement, approved by the CMU Resolution No. 847-p dated September 17, 2014; paragraph 38 of the Action Plan on Implementation of Section IV "Trade and Trade-related Issues" of the Association Agreement, approved by the CMU Order No.217-p dated January 18, 2016.

74 *See* paragraphs 554-565 of the Action Plan for Implementation of the Association Agreement, approved by the CMU Resolution No.1106 dated October 25, 2017.

75 The Draft Law of Ukraine "*On Introducing Amendments to the Customs Code of Ukraine on Protection of Intellectual Property Rights While Moving (Transferring) Goods across Customs Border of Ukraine*" No.4614 dated May 06, 2016.

A key step towards implementation of the requirements set forth in the Regulations No 608/2013 and 1352/2013 should be the adoption of the Draft Law of Ukraine No.4614 of 06.05.2016, introduced by the Government.[75] However, on March 13, 2018, despite approval by the specialized committee, its consideration was postponed by the Verkhovna Rada.

The IPR protection issue is also addressed in Section 15 of the EU Customs Blueprints[76], prepared by General-Directorate for Taxation and Customs Union of the European Commission, recommended to be used by customs administrations to review administrative and operational functions and to bring the relevant procedural rules and procedures in line with EU standards.

Use of the EU Customs Blueprints as a benchmarking tool is foreseen by the Association Agreement while the Government contemplates using them as the basis while elaborating concept of reform of customs authorities in Ukraine .

As for the provisions set forth in the EU Customs Blueprints, that are aimed at creating a central IPR unit, a center of operational expertise under the customs administration, are worth particular mentioning. In the Council's view, improving professional competence of customs authorities' officers in the IPR sphere and concentration of competence in the relevant specialized structural unit can significantly strengthen the institutional capacity of the customs in promoting IPR protection.

THE COUNCIL'S RECOMMENDATIONS:

In order to bring Ukrainian legislation in the field of protection of intellectual property rights while transferring goods across customs border of Ukraine in compliance with the requirements and standards employed in the EU, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine** and **the State Fiscal Service of Ukraine** – to prepare amendments to the existing Draft Law of Ukraine No.4614 dated 06.05.2016 "*On Introducing Amendments to the Customs Code of Ukraine to Ensure Protection of Intellectual Property Rights While Moving Goods Across Customs Border of Ukraine*" No.4614 dated 06.05.2016; or to introduce an alternative draft law to ensure implementation in Ukraine of the requirements set forth in (i) Regulation (EC) No 608/2013 of the European Parliament and of the Council regarding customs enforcement of intellectual property rights; as well as (ii) Commission Implementing Regulation (EU) No. 1352/2013 establishing the forms provided for in Regulation (EU) No 608/2013, in particular:

   1.1. To bring the concept "*goods infringing Intellectual Property Rights*" in line with EU requirements, including exclusion of goods that are objects of so-called "parallel trade" from the substantial scope of this concept (in accordance with Clauses 3-5 of Article 1 of Regulation No. 608/2013);

[76] *See* at the following link: https://publications.europa.eu/en/publication-detail/-/publication/ad5f6272-7687-11e5-86db-01aa75ed71a1.

[77] *See* Article 80 of the Association Agreement.

[78] *See* Paragraph 450 of the Action Plan for Implementation of the Association Agreement, approved by the CMU Resolution No.1106 dated October 25, 2017.

[79] *See* Blueprint 15.3-15.9 of the EU Customs Blueprints.

1.2. To set forth clear procedural terms, unified with European Union requirements, applicable within the procedure for suspending customs clearance of goods suspected of infringing IPR (as stipulated by Articles 3, 7, 9, 11-12, 17-18, 23, 26 of the Regulation No.608/2013);

1.3. To improve the regulation of the procedure for destruction of goods, whose customs clearance has been suspended on suspicion of violating IPR, including laying down the "*tacit consent*" principle for their destruction in the absence of objections from a declarant or owner of goods; establishing a simplified procedure for the destruction of goods containing in small consignments (according to Articles 25 – 26 of Regulation No. 608/2013);

1.4. To approve unified IPR protection measures related forms in accordance with European Union standards (as prescribed by Regulation No.1352/2013).

2. **The Ministry of Finance of Ukraine**, **the State Fiscal Service of Ukraine** – to implement Clauses 15.3 – 15.9 of the European Union Customs Blueprints, – in particular, to create a central IPR unit as a center of operational expertise under the State Fiscal Service of Ukraine.

3 STRATEGIC AREAS OF CUSTOMS SPHERE REFORM

Due to ongoing trend towards eurointergation and resulting need to improve positions in various international rankings Ukraine's legislation in the customs sphere is undergoing active reformation.

Introduction of the so-called "single window" at customs – the principle, which means that declarant directly interacts only with customs and does not have any contacts with other authorities tasked to perform various types of mandatory control – i.e., sanitary and epidemic, veterinary, phytosanitary, ecological, radiological etc. – is, ostensibly, the most well-known reform in this sphere.

The application of this principle stems from Ukraine's international obligations and best international practices[80]. Besides, the application of this principle is one of factors that influences Ukraine's position in international rankings[81].

Therefore, we consider as a major step forward that on 5 July 2018 Verkhovna Rada adopted Draft Law of Ukraine No. 7010[82] aimed at bringing more than 40 laws in line with this principle, and making possible to implement it comprehensively. In the Council's view, in future business will definitely benefit from implementation of this mechanism[83].

Apart from "single window", other novelties such as (1) concept of AEO; and (2) shift towards post-clearance audit as the main form of control over due payment of customs duties and fees, – are also aimed at ensuring considerable simplification of conditions for doing business in Ukraine.

However, implementation of the foregoing initiatives in the national legislation and in the actual practice of enforcing laws and regulations requires well-balanced and systemic approach, which would allow minimizing temporary inconveniences faced by business while the foregoing institutes will have been formed.

Hence, the following outlines Council's view on how to attain this objective in each of the abovementioned strategic areas of customs sphere reform.

[80] *See*, in particular, Clause 4 of Article 10 of the TFA; Clauses 8.16 and 11.9 of the EU Customs Blueprints; Clause 1.3.8 of the Framework of Standards to Secure and Facilitate Global Trade (June 2005); Recommendations 33 to 36 of the United Nations Center for Trade Facilitation and E-business of the United Nations Economic Commission for Europe (link: http://www.unece.org/tradewelcome/un-centre-for-trade-facilitation-and-e-business-uncefact/outputs/cefactrecommendationsrec-index/list-of-trade-facilitation– recommendations-n-31-to-36.html)

[81] For example, in Global Trade Report 2016 Ukraine ranked 95th by the index "*Efficiency and transparency of border administration*"; occupied 110th place in the "*Customs services index*" component; and 104th – in the "*Efficiency of the clearance process*". In addition, the source of information for calculations was the Customs Capability Report of the Global Express Association (GEA) (information about Ukraine was last updated there on November 16, 2017). The answer to the question "9a. Are there multiple inspections (inspections by agencies other than Customs?)" is "Yes", to "9b. If the answer above is "yes," are other agency inspections causing delays in delivery?", the answer is "Yes."

[82] The Draft Law of Ukraine "*On Introducing Amendments to the Customs Code of Ukraine and Certain Other Legislative Acts of Ukraine Regarding Introduction of a "single window" Mechanism and Optimization of Control Procedures When Transferring Goods Across the Customs Border of Ukraine*" No.7010, dated July 27, 2017.

[83] The Council is aware that on July 27, 2018 the Draft Law No.7010 was returned to the Verkhovna Rada of Ukraine with suggestions of the President of Ukraine. Nonetheless, as these suggestions do not relate to any essential aspects of operation of a "single window", it can be reasonably expected that the procedure of adoption of this Draft Law will be completed in the nearest future.

3.1 Implementation of the "authorized economic operator" concept

Back in 2005, in the World Customs Organization (**the "WCO"**) documents, the term "authorized economic operator" or **"AEO"**) was defined as a party involved in the international movement of goods, that has been approved by a national Customs administration as complying with necessary security standards.[84]

In lieu of the assumption of EEO's compliance with strict eligibility requirements, the holders of such status are eligible to claim simplification of certain customs procedures, while other economic operators have to prove such compliance in accordance with the general procedure.

In the EU, for instance, AEO's enjoy the whole range of benefits such as (i) simplification of the movement of goods between Member States (temporary storage); (ii) discounts in terms of cost of financial guarantees; (iii) centralized customs clearance of goods; (iv) self-assessment of one's own activity; (v) more favorable attitude to risk assessment and control, etc.[85]

In Ukraine ensuring full-fledged functioning of the AEO scheme has, for quite a long time, been perceived as one of the key tasks of state customs policy. Meanwhile, since nominal legislative recognition of this mechanism in the Customs Code of Ukraine back in 2012 (with the original name " Empowered Economic Operator" (**"EEO"**), there has not been any significant progress in its' actual practical implementation. Thus, despite formal recognition of importance of AEO mechanism,[86] the respective international obligations of Ukraine[87] remain unfulfilled.

In particular, the Draft Law of Ukraine No. 4777 (**"Draft Law No.4777"**)[88] registered back in 2016, was returned for finalization as many substantial discrepancies has been found with the provisions of EU customs legislation (in particular, due to certain amendments introduced to the EU legislation in the field).[89]

In December 2017, another Draft Law No.7473 (**"Draft Law on AEO"**)[90] was registered in Verkhovna Rada. However, even though this document might be viewed as the most promising one, there are certain concerns (including those ascertained by the Council while working on the Report when communicating with representatives of expert community) still compounding implementation of AEO mechanism at legislative level. And it appears that primary concern relates to the risk of possible abuse of AEO status upon its' acquisition by an inner circle of "selected" economic operators.

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84 *See* WCO's "*Framework of Standards to Secure and Facilitate Trade*" (SAFE), approved by the Resolution of the Customs Co-operation Council at its 105/106 session on 23-25 June, 2005 in Brussels.

85 In EU legislation, the AEO mechanism is governed by the EU Customs Code, established in Regulation (EC) No. 952/2013 dated October 09, 2013 (Union Customs Code); the Commission Implementing Regulation ((EC) 2015/2447) dated November 24, 2015; and Commission Delegated Regulation ((EC) 2015/2446) dated July 28, 2015

86 Government Priority Action Plan for 2018, approved by the CMU Resolution No.244-p dated March 28, 2018.

87 The mentioned Draft Law was elaborated in accordance with Article 84 of the Association Agreement between Ukraine, on the one hand, and the European Union, the European Atomic Energy Community and their Member States, on the other hand.

88 Draft Law of Ukraine "*On Introducing Amendments to the Customs Code of Ukraine Regarding Authorized Economic Operator and Customs Formalities' Simplifications*" (see in Ukrainian at: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=59320).

89 Conclusion of the Committee of the Verkhovna Rada of Ukraine on Tax and Customs Policy, approved at a meeting on June 21, 2017 (Minutes No.66).

90 *See* Draft Law of Ukraine "*On Introducing Amendments to the Customs Code of Ukraine (regarding certain issues of implementation of Chapter 5 of Section IV of the Association Agreement between Ukraine, on the one hand, and the European Union, the European Atomic Energy Community and their Member States, on the other hand)*" No.7473, dated December 29, 2017 (*see* in Ukrainian at the following lnk: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=63291).

Therefore, the following outlines several aspects, which, in the Council's view, should be taken into account in further legislative work on creating prerequisites for successful implementation of AEO mechanism in Ukraine, which would comply with the best international practices. In particular, we mean: (i) pre-authorization audit; (ii); time limits for conducting compliance criteria assessment for granting AEO status; (iii) grounds for AEO status suspension and revocation and; (iv) recognition of AEO status obtained in other countries.

(a) Pre-authorization audit

The risks of possible abuse of AEO status by dishonest businesses should definitely be taken into account. Using AEO status for illicit purposes can not only cause significant economic losses to the State, but also undermine the trust of international partners.

Yet, as obtaining AEO status is a lengthy process that can take months (for example, in the UK, estimated time frame is 4 months from the date of application submission) the foregoing risk should be avoided by thorough pre-authorization audit.

Besides, in order to enhance trust in AEO status obtained in Ukraine, it appears it would be reasonable to engage foreign specialists to train auditors and conduct actual audits, at least during the first years of implementation of AEO mechanism. Among other things it might help to promptly identify gaps/differences in national legislation and adjust it to the international one.

(b) Time length for assessing compliance with eligibility criteria

The Draft Law on AEO establishes a 120-day time frame for assessing compliance with eligibility criteria set for granting AEO status without envisaging grounds for its possible extension. Yet, it appears to be reasonable to foresee the possibility of going beyond this period (suspension of its running), for example, in cases when it is necessary to obtain additional information from a prospective candidate and its' disclosure might require a significant time.

(c) Grounds for AEO status suspension and revocation

The procedure for suspending AEO status is as important as its obtaining. Hence, from the Council's point of view, such a ground as "conducting a pre-trial investigation regarding EEO officials " (as specified in the Draft Law on EEO № 4777) should not constitute a self-sufficient ground to suspend the status, given current level of criticism of the law enforcement system as a whole.

In addition, given inadequate legislative treatment of the sphere of liability for customs rules infringement , it is questionable whether such ground for revocation of AEO certificate as committing infringement of customs rules is actually well-grounded too.

For example, an incorrect determination of UCGFEA code, or mistaken provision of incorrect documents not containing information about the product for customs clearance (the invoice is for the wrong batch) and declaration of such incorrect data, may result in prosecution under Article 472 or 483 of the CCU, entailing significant sanctions. Such sanctions very often do not correspond to the social danger of the action and actual damages (losses) suffered by the State as a result of such an action. Hence, as such approaches to holding a person liable for infringing customs rules are incompatible with European ones, – unless changed they can easily undermine significance of AEO status.

[91] *See* Section 2.4 of this Report.

In the Council's view, in all cases related to AEO status revocation due to alleged infringement of customs rules, the one should ascertain existence of connection between the amount of losses (losses of the State/unpaid taxes) suffered to such violations and the total invoice value of goods that were moved by a declarant through the customs border of Ukraine for the same period of previous year.

Hence, in such a case, the amount of damages (losses of the State) should constitute the difference between the amount of payments that should have been made upon correct documenting of goods and the amount of payments declared and/or paid by an AEO with committed infringements. Such an approach may allow mitigating risks of being brought to liability for breach of customs rules (entailing confiscation of "objects of infringement") by employing purely formal grounds.

(d) Recognition of AEO status obtained in other countries

It is also important to properly regulate the procedure for recognition of AEO status obtained in other countries with whom Ukraine has relevant agreements, including scope of simplifications granted to AEO. Among other things it is necessary to clearly specify parameters of such status, including scope of simplifications applied in cases where, for example, AEO (as an exporter) is not actually responsible for clearance of goods by importer not having the appropriate status.

THE COUNCIL'S RECOMMENDATIONS:

To ensure implementation of AEO mechanism in Ukraine the Council recommends as follows:

1. **The Verkhovna Rada of Ukraine** – to ensure existence of effective legal framework on governing mechanism of authorized economic operators, which would be consistent with the relevant European Union legislation, – to ensure prompt adoption of the Draft Law of Ukraine No.7473, whose provisions would, *inter alia*, foresee:

   1.1. Grounds for extension (or suspension) of 120-day time period for conducting assessment of compliance with Authorized Economic Operator eligibility criteria to enable requesting from a candidate (and corresponding disclosure) of additional documents and information – for instance, when additional information is required to ensure a comprehensive compliance assessment, whose disclosure requires significant time.

   1.2. That existence of a pre-trial investigation in a criminal proceeding should not, by itself, constitute a self-sufficient ground for suspending Authorized Economic Operator status (contrary to what was envisaged by the Draft Law of Ukraine No.4777).

   1.3. That while contemplating revocation of Authorized Economic Operator status due to infringement of customs rules, it is mandatory to ascertain existence of connection between the amount of losses (losses of the State/unpaid taxes resulting from such infringements) and total invoice value of goods that were moved by an entity across customs border of Ukraine during period of time employed by customs administration for conducting such a comparison.

2. **The Ministry of Finance of Ukraine** – to adopt a secondary legislative act (in the form of an order), which would establish the possibility and necessity (at least for the first two or three years while Authorized Economic Operator mechanism is being put into operation) to engage foreign specialists to train local personnel and actually conduct audits, required for granting Authorized Economic Operator status.

3.2 Change of customs control's ideology. Switch to post-clearance audit procedure.

The global development of trade ties and recognition by states of the need to facilitate a rapid movement of goods have led to recognition of inefficiency of traditional approaches to carrying out customs control directly at the border before releasing goods for circulation. Even 1973 International Convention On the Simplification and Harmonization of Customs Procedures (Kyoto Convention) recognized and introduced the need to shift the emphasis from customs control to post-clearance audit procedures.

Indeed, as lengthy customs clearance at the border results in additional expenses for business, – it cannot be justified merely by the need to carry out customs control. This encourages seeking opportunities for carrying out customs control after release of goods into free circulation. Not only such an approach became increasingly widespread at the national level but it was specified in international sources too, particularly in the TFA of 2013.

It is worth noting that the approach whereby audit of compliance with the requirements of customs legislation is conducted following completion of customs clearance of goods is far from being new in Ukraine[92]. Yet, to the best of the Council's knowledge, in the vast majority of cases, customs authorities tend to incline declarants to perform all control activities directly at the time of clearance – i.e., until the goods have been released.

Nonetheless, post-audit is becoming increasingly widespread. In 2017, the SFS has reportedly conducted 626 documentary audits on customs matters,[93] which is almost twice more than in 2016[94].

Ukraine's ratification of the Revised Kyoto Convention and the TFA has created the need to ensure implementation of their provisions, including those contemplating audit after customs clearance.

Yet, the following outlines a number of priority aspects, which, in the Council's view, should be considered in further work on introduction a post-clearance audit in Ukraine, (to be based on the EU Customs Blueprints as a main guideline, which, in any case, is Ukraine's obligation under Article 80 of the Association Agreement) namely: (a) the existence of an effective institutional environment; (b) the need to separate release of goods into free circulation from final determination of the amount of customs duties; and (c) the use of information technologies.

[92] *See* Article 41 of the CCU.

[93] *See* at the following link :http://sfs.gov.ua/media-tsentr/novini/333421.html.

[94] Such statistics should, however, be evaluated by taking into account whether corresponding obligations are agreed (i.e., in case of administrative or court appeals, information about their results should be studied); and what was the real time spent by declarants for customs clearance (constituting basis for imposition of additional payments). Such data might influence interpretation of the increased number of audits conducted.

(a) Effective institutional environment

In the Council's view, it is impossible to ensure proper efficiency of post – clearance audit only by vesting controlling bodies with designated authority.

One of the most common arguments used by those criticizing post-clearance audit introduction is the risk of being unable to collect payments owed to the budget in cases when – after release of goods into free circulation a legal entity-importer ceases to exist.

Indeed, ensuring inevitability of punishment for fraud and/or possibility to collect appropriate funds from importers (if obligation to pay is imposed based on the outcomes of audit) in case of actual termination of activity of such companies is unlikely to entirely fall within the framework of the ongoing customs reform.

Thus, proper functioning of the post-clearance audit control mechanism depends not only upon the work of customs authorities but also the efficiency of the judicial system, law enforcement and bodies of the executive branch of government.

(b) Release of goods should not depend on final determination of the amount of customs duties

In the Council's view, for successful implementation of post – clearance audit, the possibility to release goods into free circulation should not depend upon occurrence of the final determination of the amount of customs duties, taxes, fees and levies[95]. Hence, it is worth noting here that from purely economic perspective, for a prudent declarant, it might be more beneficial to ascertain the existence of infringements already at the border.

For example, if clearance is based on customs value set by the customs, customs value of goods will be adjusted, thus almost all payments difference is going to be allocated to a company's tax credit[96]. Yet, if the same violation were to be ascertained at post-clearance audit stage (resulting in appearance of the so-called "agreed monetary obligations"), – the company would have to pay the difference (without the right to allocate it to a tax credit) along with penalties.[97]

Therefore, it appears to be reasonable to vest a declarant with the right to choose between control at the border or subsequent post-clearance audit. To ensure a declarant's ability to choose, the customs authority shall notify the former about both doubts it might have regarding information furnished with the customs as well as about declarant's right to choose as such.

Besides, assessment of switch to post-clearance audit procedure should be made by taking into account time and economic losses for every customs procedure, including those related to challenging possible disputable situations.

This can be seen in the example of the length of time required for confirming declared customs value involving, inter alia, the process of preparation and provision by a declarant of additional (requested by customs) documents (or denial thereto)[98] and eventual decision on customs value adjustment to be rendered by the customs. The actual

[95] This, in fact, is referred to in Para. 3 of the Article 7 of the TFA.

[96] Article 198 of the CCU.

[97] Chapter 11 of the Tax Code of Ukraine.

[98] Pursuant to Clause 6 of Paragraph 2 of Article 255 of the Criminal Code of Ukraine, the term specified in part one of this article may be extended taking into account time required for execution of certain formalities; particularly in case of submission of additional documents in accordance with para. three of Article 53 of this Code within the period stipulated hereunder, whose lapse is terminated upon customs (customs point) receipt of such documents or a written refusal of a declarant or authorized person to provide them.

time required to complete all such steps might entail disproportional expenses for an importer and induce it to concur with the position of the customs authorities.

Hence, the situation when business (being driven by merely economic considerations) might be forced to concur with the position of customs authorities rather than challenge thereof cannot be regarded as acceptable. It goes without saying that in such conditions post-clearance audit control cannot be regarded as having been properly implemented.

The same observations are applicable to procedures employed in case of infringing customs rules. To ensure prompt release of goods, in accordance with Clause 3.4 of Article 7 of the TFA, if an offense contemplating imposition of monetary sanctions or fines is detected, a guarantee might be required to secure payment of such possible sanctions and fines.

Hence, in the Council's view, one of the key conditions for ensuring a real switch to post-clearance audit procedure is introduction of systemic evaluation of real time (hours) required for each procedure, including regular publication of its results (considering the TFA requirements).[99]

(c) Use of information technologies (software)

Another important aspect is the use of It technology[100]. The experience of some countries shows that introduction of a modern software solutions can significantly simplify and enhance the efficiency of customs authorities, as well as alleviate the administrative burden imposed on the declarants.

Within the framework of European integration process, maximum attention should, of course, be paid to the experience of the European countries in terms of coordination (ensuring interaction between) of relevant It systems. The experience of other countries shall also not be ignored. In particular, one can highlight the experience of Pakistan, where with introduction of WeBOC ("Web based one custom") software product a remarkable increase in tax revenues by 47% has been achieved[101]. This software product may be used on mobile phones, is downloadable from online stores and, hence, is subjected to rather open quality evaluation.

[99] Notably, pursuant to Article 6.1 of the TFA members are recommended periodically and on an ongoing basis to measure and publish data on average time for release of goods using, among other things, such tools as "Time Release Study" of the World Customs Organization (**the "WMO"**).

[100] *See* the Direction 16 of the Action Plan of the Ministry of Finance.

[101] *See* at the following link: http://pral.com.pk/Projects.html https://www.weboc.gov.pk/(S(hqvlvr1j5cv0f2ezdo05t5du))/Login.aspxNo.

THE COUNCIL'S RECOMMENDATIONS:

In order to ensure a gradual switch to post-clearance audit control procedure, the Council recommends as follows:

1. **The Ministry of Finance of Ukraine** and/or **the State Fiscal Service of Ukraine** – to ensure openness of data about average time required for release of goods, taking into account methodology contained in the "Time Release Study" document of the World Customs Organization.[102] The relevant data can be regularly published at the official website of the SFS of Ukraine. Along with the publication of this data, an interactive survey of companies should be carried out in terms of such data's authenticity/acknowledgement.

2. **The Ministry of Finance of Ukraine** and/or **the State Fiscal Service of Ukraine** – to introduce a transparent system for evaluating the effectiveness of post-clearance audit of companies; based on which risk criteria for operations and/or enterprises should be continuously updated. The relevant statistics should be disclosed and provided on a regular basis (on quarterly and annual basis), according to the following indicators:

   i. the number of carried out audits;

   ii. total amounts of additionally imposed charges with a separate indication of the amount of so-called "agreed obligations";

   iii. percentage correlation between the total number of inspections and audits where an additional charge was imposed in the amount exceeding certain indicator (this indicator may be set as a fixed UAH amount or as a percentage of the total amount of operations of the company that became the subject of an audit). The introduction of the relevant indicator will enable systemic assessment of post-clearance audit effectiveness, preventing small amounts from distorting overall figures;

   iv. percentage of audits (amongst the total number of inspections) where customs declarations were checked without physical examination of goods and/or seeking disclosure of additional documents and/or issuing decisions on classification of goods and/or adjustments of customs value;

   v. percentage of customs declarations whose clearance involved employing customs control measures in the form of physical inspection of goods and/or request for additional documents, making decisions regarding classification of goods and/or adjustments of customs value;

   vi. financial indicators demonstrating outcomes of customs control measures in the form of physical inspection of goods and/or request for additional documents, making decisions regarding classification of goods and/or adjustment of the customs value;

   vii. the number of cases launched for infringing customs rules;

   viii. the total amount of sanctions imposed to customs rules infringers following consideration of cases on infringement of customs rules;

   ix. percentage correlation between the total number of cases on customs rules infringement and cases where sanctions were imposed on infringers.

[102] *See* at the following link: http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/tools/time-release-study.aspx

3. **The Ministry of Finance of Ukraine**, **the State Fiscal Service of Ukraine** – in order to control the declared customs value, ensure functioning of the system of interaction between fiscal authority and a declarant, where all information exchange will be carried out in electronic form. It appears it might be achieved by introducing changes to the respective software of the State Fiscal Service of Ukraine.

4. **The Ministry of Finance of Ukraine**, **the State Fiscal Service of Ukraine** – to ensure a gradual switch of customs value control from customs clearance to post-clearance audit stage, save when fiscal authority has reasonable doubts (to be justified by the respective criteria) about ability to collect amounts of additionally imposed charges in the future. For instance, use of risk-oriented system based on score-ranking method is advisable *vis-à-vis* entities incorporated shortly before customs clearance, where managers/owners have changed or have been brought to criminal or administrative liability. It appears that initially such a switch of control could be determined in methodological recommendations (letters) issued by the State Fiscal Service of Ukraine and/or the Ministry of Finance of Ukraine followed by introducing respective amendments to the Customs Code of Ukraine.

5. **The Ministry of Finance of Ukraine** and/or **the State Fiscal Service of Ukraine** – update software employed for communication between the State and declarants. Based on successful examples of other countries – to ensure functioning of a single, up-to-date online system that would maximize automation of relevant iterations, simplify declaring procedures and ensure transparency.

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