

E-commerce at the Border

Understanding customs and indirect taxes for
United States and European Union markets



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About the paper

This report helps small businesses comply with trade rules when selling goods through e-commerce to the European Union and the United States. It addresses related import conditions and the role of customs authorities in collecting duties for e-commerce. In addition, the report covers the importance of correctly accounting for and paying indirect taxes. It also explains the new procedures that the European Union is introducing from July 2021 implying new obligations for sellers and marketplaces.

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Foreword

If e-commerce was not previously a priority for many micro, small and medium-sized enterprises around the world, the COVID-19 pandemic dramatically changed that. Firms that were unprepared for online sales faced a stark choice: watch sales dry up or innovate quickly.

At the International Trade Centre, we have been heartened by the many stories of resilience, with a number of entrepreneurs in developing countries making that switch to e-commerce as a means of making sales. This has allowed many to survive, and quite a few to thrive.

This report stems from our work supporting women entrepreneurs and business owners in Central America, many of whom look to the United States and Europe to capture demand and better prices through e-commerce. We offer our insights from this work, so that a wider range of small enterprises understand how to comply with trade rules when selling goods through e-commerce channels to Europe or the United States. With changing rules and regulations, small enterprises need to be aware and anticipate any new requirements.

Yet even success stories can be fragile. As small businesses build an international clientele via e-commerce, they may grow more quickly than their capability to manage compliance in different markets. Getting it wrong can lead to significant fines or closure of international operations.

This is where the benefits of trade facilitation can be most directly experienced: ensuring that small enterprises are not barred or discouraged from taking part in international trade through a lack of understanding and application of the appropriate procedures.

Increasingly, we see the power of networks – and the value that small enterprises place on learning from their peers. We hope that these insights from our own networks are useful to a wider audience, and we can continue to broaden exchanges among peers, as we have seen in our ecomconnect.org platform.

We stand ready to work with all small businesses and to share our learning for the benefit of future e-commerce champions from developing countries.



Pamela Coke-Hamilton
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Acronyms

Unless otherwise specified, all references to dollars (\$) are to United States dollars, and all references to tons are to metric tons.

DAP	Delivered at place
DDP	Delivery duty paid
DTU	Duties and taxes unpaid
EU	European Union
FTA	Free trade agreement
HS	Harmonized System
IOSS	Import One-Stop Shop
ITC	International Trade Centre
MFN	Most favoured nation
TARIC	Integrated Tariff of the European Union
VAT	Value-added tax
WCO	World Customs Organization
WTO	World Trade Organization

Executive summary

The growth of cross-border e-commerce in the last 20 years means some small enterprises have been ‘born global’ – that is, they serve an international customer base from founding. The most successful of these ‘micro multinationals’ learn to navigate the intricacies of international trade, including the correct handling of taxes and duties.

Failure to do so can create a cascading set of consequences: international customers unhappy to receive surprise demands for additional payment on delivery, the rejection and return at great cost of many of those deliveries, damage to reputation and lost business, payment demands from customs and tax authorities, sanctions from online marketplaces and eventual failure of the business. This cycle of failure is far too common among many small enterprises that transition from informality to the tempting, high-potential world of e-commerce.

This publication is an introduction to the handling of customs procedures, and the application of duties and taxes for small firms in cross-border e-commerce. The subject is vast and full of complexity, even if based on some simple principles. To introduce these principles, this guide focuses on two large markets that are often the priority for small sellers: the European Union and the United States. Some examples are taken for how to evaluate the applicable rate of import duties and how to calculate the correct rate of taxes.

Understanding the principles, and application, of duties and taxes may even be more fundamental to a small business than correctly quoting the full door-to-door price to its international customers. Depending on the origin country, the type and value of goods being sold in some marketplaces may offer an opportunity to be more competitive. For instance, the United States sets an \$800 ‘de minimis’ on customs duties – meaning that most goods below this value can enter without the need to pay customs charges. Similarly, it is useful to know where preferential rates have been negotiated between countries and to target these markets.

Obtaining such information can be intimidating for many small enterprises. However, through its Market Access Map, ITC offers a tool that makes such inquiries relatively straightforward to investigate. The first step is understanding the product classification description. This publication introduces the different forms of classification in use and related concepts such as ‘rules of origin’ – which describe where the product and its inputs are sourced to determine if a particular trade deal applies.

For small enterprises choosing to serve a few selected marketplaces with a limited range of products, it is a relatively straightforward matter to calculate the applicable duties and taxes. One simple solution is to work with transport providers that can propose the delivery duty paid Incoterm – paying a premium to the vendor for this service.

Nevertheless, discipline is required to review and update the calculations regularly. With increased size and complexity, other solutions become appealing – including engaging the services of professionals such as accountants, export brokers or third-party logistics providers. But even when the technicalities are delegated to such experts, the small enterprise must understand the principles and control the work being undertaken on its behalf, as liability for mistakes can come back to the seller.

How to ensure trade compliance

Ensuring trade compliance¹ involves researching the specific requirements for each target market, including product standards, packaging, customs duties and tax requirements. A third-party logistics provider can act as a customs representative to facilitate the export process, but it relies on the seller to provide correct and complete information on the product.

¹ In this report, trade compliance refers to customs procedures, customs duties and value-added tax/sales tax obligations of e-commerce sellers. However, it is important to note that trade compliance covers additional issues including, for example, safety standards and certificates, and packaging requirements for cross-border shipments.

Sellers are usually asked to provide details including their own and their buyers' account numbers; addresses for pick-up and delivery; the terms of sale; the value of the goods; a description of the products; the number of packages; gross weight and dimensions; the tariff code; the country of origin; and a certificate of origin if a preferential tariff is applicable. Based on the information provided by the seller, the third-party logistics provider will prepare the import documents required by the customs authorities of the country of destination.

Sellers may also need to pay taxes when exporting goods to another country. While customs administrations collect customs duties, sellers collect indirect taxes and transfer them to tax administrations. European Union (EU) countries apply value-added tax (VAT) and the United States applies sales tax.

How does value-added tax work?

Consumption taxes such as VAT, sales tax and excise duties are often categorized as indirect taxes. This is because they are not directly imposed on intermediaries, but on certain transactions, products or events and finally borne by the end consumer.

Many countries offer exemptions to the payment of these taxes. These exemptions allow companies trading low-value export consignments to take advantage of the de minimis regime, whereby no indirect taxes are collected. However, some countries limit the type of tax exemptions available to sellers – mostly micro, small and medium-sized enterprises – of low-value consignments. As of 1 July 2021, the European Union will remove the current VAT de minimis exemption for low-value goods previously set at a value of up to €22 (\$27).

Value-added tax is paid on purchases by end consumers, manufacturers, suppliers or distributors, who can receive a credit for the tax they have paid through their VAT return if the goods are resold. In the internal market, the European Union has one VAT system. However, even though all EU countries follow the same VAT principles, the detailed rules differ from country to country.

When a business is established outside the bloc, import VAT is payable on the release into free circulation of goods imported into the EU from a non-European Union country. VAT registration in the EU is only required for sellers outside the bloc if a European Union-based warehouse is used or the seller's revenue reaches a certain threshold.

Starting on 1 July 2021, value-added tax registration will be required for all non-EU sellers selling goods to European Union consumers unless another method is used to pay import VAT, for example, through an online marketplace. VAT registration will only be required in one European Union member state.

If sellers use marketplaces (such as Amazon), the marketplace will be responsible for collecting VAT for goods with a value up to €150. E-commerce businesses selling through these platforms from outside the EU may not need to register for VAT for lower value goods, as the marketplace will be responsible for these obligations. Small firms are advised to study the information provided by their marketplace.

How does sales tax work?

Sales tax is similar to VAT, but is only charged once, at the last point of sale. This means that, in principle, only consumers are charged the tax and resellers are exempt if they are not the end users of the product. Sales tax is imposed and administered at state and local levels and not at the national level, adding to the complexity for non-US sellers. Certain states require a non-US business selling online to customers in the United States to register for sales tax, depending on whether the firm meets the criteria for the sales tax 'nexus'. Local tax advisory may be necessary.

The subject has a high degree of specificity and changes continually. Companies are urged to check online sources of information or consult with a tax adviser regularly. This publication provides several examples, where calculations are shown for producers from outside the European Union and the United States in relation to their liabilities for duties and taxes. References are given to external databases, such as those managed by ITC as well as the EU and US authorities.

Despite the apparent complexity of the topic, there are solutions and alternatives to reducing the burden of calculating and paying taxes and duties. Innovations in the way platforms collect taxes are set to continue and probably accelerate. This introductory guide is only the beginning: getting it right can be a source of competitive advantage and the foundation of becoming a successful micro-multinational.

Chapter 1

Online sellers need predictable and clear rules

One of the challenges facing micro, small and medium-sized enterprises engaged in cross-border e-commerce is the constantly changing e-commerce regulatory framework, which can make it difficult to comply, especially when it comes to customs duties and indirect² taxes. E-commerce sellers (and their customers) need predictable and transparent rules to trade successfully in global markets. This means information about trading conditions as well as requirements and procedures in target markets is vital.

Changing and highly dynamic e-commerce legal frameworks around the world mean that small and medium-sized enterprises have difficulty meeting target market requirements. Matters related to customs procedures and the payment of customs duties and (indirect) taxes appear particularly challenging for small companies.

The growth of e-commerce has put government authorities under intense pressure to ensure the collection of appropriate revenue, apply safety and security controls, protect intellectual property and facilitate trade at the border. This implies collaboration among actors such as logistics vendors and traders, digitizing the flow of information and facilitating the growth of import traffic.

At the World Trade Organization (WTO), a group of countries is reviewing how a new agreement on e-commerce could be defined. In parallel, members of the World Customs Organization (WCO) are working towards standards agreed under the Working Group on E-Commerce, including the Framework of Standards on cross-border e-commerce.

Governments often use free trade agreements (FTAs) to discuss and remove e-commerce related barriers. However, they continue to impose stringent conditions for exports to qualify for the benefits agreed under an FTA, such as the often complex 'rules of origin'. The WTO and the WCO provide a platform for governments to negotiate and agree on more harmonized standards and rules.

To deal with the new reality of high-volume, low-value shipments entering the country, the United States Customs and Border Protection introduced a strategy in March 2018 to ensure safety and security while facilitating trade in the new e-commerce environment. This new strategy addresses the growing volume of small package imports as well as the challenges and opportunities of business-to-consumer e-commerce for the economy and security of the United States.

In the European Union, e-commerce is one of the focus areas of the Digital Single Market Strategy, which the European Commission launched in 2015. The main goal of the strategy is to break down online barriers that prevent people from enjoying full access to all goods and services offered by businesses in the European Union. This includes, among other things, ending unjustified cross-border barriers, facilitating cheaper cross-border parcel deliveries and protecting the rights of online customers.

Since 2016, greater emphasis has been placed on online platform responsibility, such as removing illegal content and addressing unfair contractual clauses and trading practices in platform-to-business relationships.

E-commerce sellers need to realize that the policy and regulatory frameworks for e-commerce – particularly in areas such as customs and indirect taxes – are always changing. For governments, e-commerce has become both an opportunity for economic growth and development and a challenge from the perspectives of securing revenue from taxes, and safety and security.

² Indirect taxes – also called consumption taxes, are taxes that are levied on goods and services before they reach the customer, who ultimately pays the indirect tax as a part of the market price of the product or service purchased. The most common examples are 'sales tax' (commonly applied in the United States) and 'value-added tax' (such as that applied in the European Union).

Chapter 2

Implications of goods crossing borders

E-commerce businesses trading internationally must understand at least some basics of the often complex processes of customs duties and indirect taxes, even if they outsource trade compliance to a third-party logistics provider. This chapter examines the customs process and the implications of customs duties to be paid by e-commerce sellers. The next chapter examines value-added tax (VAT) in Europe and sales tax in the United States.

What is the customs process?

When foreign traders sell products to the European Union (EU) or the United States, these goods are subject to customs clearance. This involves costs, such as duties and taxes, as well as time spent on paperwork and sometimes inspection. Governments frequently use customs duties, VAT and sales tax to provide revenue and protect domestic industries by controlling the incoming (and sometimes outgoing) flows of specific goods and services.³

Increasingly, governments use their trade policies less for generating revenue and more to help facilitate trade. This is certainly relevant in the case of e-commerce, where low-value goods often enter target markets free of duties and taxes under so-called *de minimis* schemes,⁴ and 'on-time delivery' demands that customs administrations handle goods quickly and efficiently.

Businesses trading goods internationally need a basic understanding of the types of customs duties or tariffs, product classifications and valuation of goods to prevent delays, fines and penalties. Customs procedures are the 'nuts and bolts' of every trade-compliance effort for firms selling on global markets.

International e-commerce sellers should also understand the basics of the trade customs clearance process, which requires certain steps and conditions to be met. The WCO generally defines a customs procedure as the treatment applied by customs authorities to goods that are subject to customs control.

Figure 1 The six-step customs process



Source: ITC.

The following steps are necessary to take a package from the moment of shipment, through customs and border procedures, to the customer (consignee).

1. The sender must provide relevant documentation, such as a pro forma or commercial invoice, when the carrier (such as a national postal firm or 3PL) collects the goods.
2. The goods are subject to customs supervision from the moment of entry until their release.
3. The goods are presented to customs authorities and will be placed under a particular customs procedure, such as end use (free circulation) or storage (for instance, in a customs warehouse). The owner of the goods or a person acting on his/her behalf, such as a customs broker, takes care of filing an (electronic) import declaration, with commercial invoice and complementary documents.

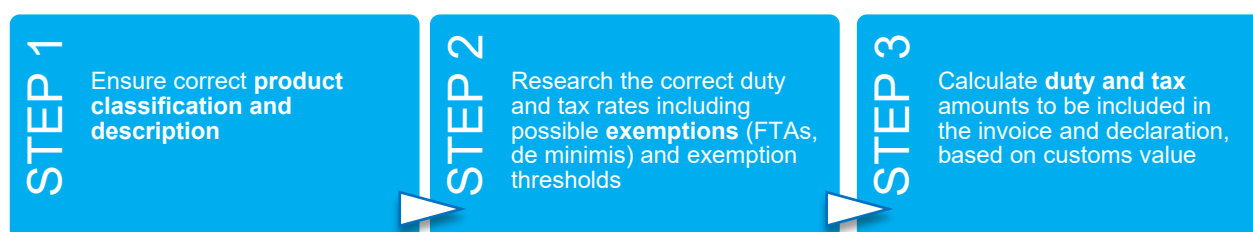
³ Excise duties are another type of indirect taxes. They are levied on the sale or use of specific products (such as tobacco or alcohol).

⁴ Some countries maintain exemptions for low-value goods. Economies including the European Union are reviewing these benefits.

4. Customs authorities carry out a risk management assessment once they receive the declaration. They may decide to hold and examine the goods and/or the declaration. They may request additional documents for verification purposes.
5. Once customs authorities have approved what has been declared, the customs declaration is released to the declarant. Customs duties and VAT must be paid by the receiver (in case of duties and taxes unpaid, or DTU)⁵ or the sender (in case of delivery duty paid, or DDP), based on an invoice for customs clearance provided by the customs representative or customs broker. Depending on the Incoterm, the customs broker prepares an invoice for whomever is expected to pay.
6. When the necessary formalities are completed and customs duties paid, the goods can be released for free circulation in the customs territory.

E-commerce sellers must give the customs broker relevant information about classification and a description of their goods, as well as the applicable customs duty. They must also calculate the actual duty to be included in their invoices based on the customs value. Although the customs broker may be able to help with these tasks, the e-commerce seller is responsible for ensuring that the broker has the relevant documents to give customs authorities for entry and clearance of goods in a foreign market.

Figure 2 E-commerce sellers must meet customs requirements



Source: ITC.

How to select the right delivery model

Businesses can choose from different models to ship merchandise to customers. The delivery model offers a way for sellers to customize key elements of the e-commerce process, such as logistics, storage, transport and (in-house or outsourced) trade compliance. Each delivery model has different customs-related requirements.

Table 1 Traders can choose from different online delivery models

Options	In-house trade compliance	Outsourced trade compliance
Selling and shipping from own stock, no local presence in target market.	Cost efficient. Some non-compliance risk. Less optimal returns process.	Moderately cost efficient. Limited risk of non-compliance. Optimal delivery (and possibly return) processes. Default scenario for this study
Using a customs warehouse in or near target market, no local presence in target market.	Challenging; requires solid in-house customs and VAT/sales tax know-how. Possible to combine with specialist tax adviser in target markets for specific issues.	Limited non-compliance risk. Optimal storage, fulfilment and delivery (and possibly return) processes. Additional costs.
Local presence in target market.	Out of scope.	Out of scope.

Source: ITC.

⁵ An example of an Incoterm – which is a standard codification for who pays which part of the costs (and liabilities) of international trade. See <https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-2020/>.

Shipping from own stock and dealing with trade compliance in-house

Firms that are just beginning their e-commerce venture can make shipments from their domestic business location and handle trade compliance in-house. With the right support, this option can keep trade compliance costs to a minimum while ensuring that e-commerce businesses satisfy international requirements.

E-commerce platforms such as Etsy, Amazon and eBay provide online guidance for handling customs and indirect taxes. Other organizations offer free webinars to help e-commerce sellers with trade compliance. Governments increasingly work with online registration platforms and 'single window' mechanisms, which are user-friendly for micro, small and medium-sized enterprises.

Advantages of in-house trade compliance include:

- Flexibility and cost-efficiency of packing and shipping your own orders from your own country.
- No additional costs for customs duties and tax handling by an external provider, although there may be some costs for external advice from a consultant.

Points to consider when choosing this option:

- Firms that are inexperienced in customs duties and taxes should realize that considerable time and investment may be needed to understand the specifics of a target market. Using trade compliance tools and carefully documenting transactions will help to implement and monitor trade compliance, reducing the risk of delays, fines and penalties.
- Consider hiring an in-house customs duties and tax expert, even on a part-time or shared basis, and/or paying for external customs duties/tax advisory services.

Shipping from own stock and outsourcing trade compliance

Most e-commerce businesses outsource the handling of customs paperwork and payment of customs duties and taxes to a customs broker instead of handling trade compliance themselves. Choosing this option ensures that when goods are shipped to an international market, a third-party logistics provider arranges for them to be delivered to the customer and pays duties and taxes to the customs authority on behalf of the customer. It is important to remember that the third-party logistics provider acts as an intermediary and that final responsibility for trade compliance lies with the e-commerce seller.

This guide uses this option as the default option to explain the trade compliance process and requirements.

Advantages of outsourcing trade compliance:

- Flexibility and cost-efficiency of packing and shipping your own orders from your own country.
- The possibility to request additional services from the logistics provider, such as 1) completing shipping documents, verifying and amending product or service codes, and paying duties, taxes or penalties required under applicable laws and regulations; 2) acting as forwarding agent for the shipper or customer for the purpose of customs duties and taxation; and 3) ensuring the shipment is redirected to an authorized party, such as customs authorities, upon request.

Points to consider when choosing this option:

- This option entails additional costs. If a firm decides to contract a logistics provider, such as DHL, UPS or a domestic postal service, for its shipments and handling of duties and taxes, a separate invoice amount will be charged for the 'customs and tax' related services provided. This will often be a flat fee per shipment, passed on to the consumer as part of the product price. It is important to remember that the fees charged by a logistics provider will usually be higher than those charged by a domestic postal service, which offers a different level of service.
- Outsourcing services for customs duties and taxes reduces a part of the trade compliance burden, but does not mean the seller can ignore trade-related market conditions, as sellers carry the final liability for trade compliance. It is important to review an agreement with a logistics provider carefully, and it may be helpful to ask a lawyer to examine the agreement. In addition, the quality standards and import and export controls of target markets need close attention.

Shipping in bulk to a warehouse and outsourcing trade compliance

Many e-commerce sellers opt to work with a functional and efficient third-party warehouse and fulfilment service to help their businesses increase productivity. Although using warehouses in or near target markets means dealing with different rules and regulations in each country, these storage facilities can reduce shipping costs and delivery times.

In practice, this means the business sends items in bulk shipments to a bonded warehouse or to a warehouse within a bonded zone, allowing for lower shipping and compliance costs. Goods are stored for re-exportation, duty-free shipments and/or release into free circulation at a later point.

This option means the e-commerce business remains an international seller, as it is not registered as having a local presence. Most e-commerce sellers store goods in a warehouse through their arrangement with a third-party logistics provider, with other options provided by e-commerce marketplaces, such as Pan-European Fulfilment by Amazon. The warehouse location is often selected based on where most of an e-commerce business's international customers are based.

Advantages of distant e-commerce sales from a warehouse:

- From a trade compliance perspective, customs duties and tax payments are deferred until a customer has ordered the goods. This means, the owner of the goods can choose when he pays the duties or re-exports the goods.
- From a logistics and inventory point of view, modern warehouses offer track and trace technologies allowing sellers to follow the product from stock to shipment. This option also enables sellers to manage their stock efficiently.
- The warehouse often provides standard packaging, removing the need to employ local staff to do the same work.
- Using bonded warehouses means that e-commerce sellers avoid complex return procedures or loss of import duties and taxes on non-delivered or refused goods. In addition, any returned products can be put up for re-sale more easily.

Points to consider when choosing this option:

- Renting warehouse space requires commitment for a certain period and reduces flexibility. However, month-to-month options are generally available.
- Once the goods are held in a warehouse, only limited working or processing of the products is allowed, depending on the rules of a country.
- Customized packaging may no longer be possible, as warehousing and fulfilment centres often force companies to use standard packaging.
- Warehouse costs may affect customs duties and taxes, and may be counted towards the customs value of the goods at the time they are imported.

Establishing a local presence in the target market

Another way to overcome customs-related hurdles is having a local presence in target markets where the server of an online marketplace is located. This means the e-commerce business has officially registered its presence in a foreign country. An e-commerce seller imports products and stores them in the target market until a customer places an order through the online marketplace.

Points to consider when choosing this option:

- The advantage here is that delivery can be made quickly through a domestic courier service, returned goods can be easily managed and bulk shipment is possible, subject to traditional customs import formalities. In different European Union countries and US states, tax incentives are available for e-commerce businesses wishing to invest in a local establishment.
- The disadvantage of this option is that it requires a long-term presence in the target market and can lead to a substantial financial investment.

In summary, choosing the right e-commerce delivery model is key to ensuring competitiveness in an international marketplace. Sellers should consider customs duties and taxes when deciding which delivery model to use when selling goods overseas. E-commerce sellers can either deal with trade compliance 'in house' or choose an 'outsourcing' model. Both models have advantages and disadvantages, but many small businesses often decide to outsource.

Even though outsourcing services for customs duties and taxes reduces part of the trade compliance burden, it is important to realize that a seller is ultimately responsible for trade compliance, which can differ in different target markets. Sellers should always check their contracts with third-party logistics providers and, if necessary, ask their customs and tax adviser to clarify liability and other clauses in the contract.

Logistics providers help online sellers meet trade rules

In online trade, it is important to distinguish between different roles to be fulfilled in the e-commerce supply chain. Most third-party logistics providers and postal services combine freight forwarding and customs brokerage services, and offer add-on services to help exporters and importers meet requirements and get products to customers.

A freight forwarder concentrates on logistics and the physical transportation of packages and cargo – that is, the export side of the trade. In the supply chain, freight forwarders organize the distribution and forwarding of the cargo on behalf of the shipper. They can also provide storage in warehouses, deal with customs documentation and fiscal matters, arrange insurance for the goods, and help pack the products.

A customs broker focuses on helping importers and exporters with legislative requirements – that is, the import side of the trade. In the supply chain, customs brokers submit information and payments to the relevant government institution on behalf of their clients.

It is important to specify the exact roles and responsibilities of the logistics service provider, who usually acts as a seller's representative. Logistics providers support and advise the foreign supplier on trade compliance, but responsibility and any liability ultimately lie with the seller.

Besides the safe delivery of the goods to the customer, logistics service providers can take care of compliance, especially customs and tax obligations. However, their key role is to facilitate domestic and international shipments and support transactions through various optional services – mostly for an additional fee, often charged per shipment, shipment value or invoice.

Enterprises have many factors to consider when choosing how to get goods to their customers:

- **Price:** According to a recent European Commission study,⁶ when it comes to prices for cross-border parcel delivery, services and costs vary widely between providers and various factors drive prices. National postal services usually offer better rates for smaller packages, with fewer additional costs and charges. Sellers in an area defined as remote may be subject to 'remote area surcharges'.⁷
- **Delivery times:** Third-party logistics providers can often deliver packages more quickly than national postal services. This is not always the case, however, so sellers should compare delivery times before deciding which service to use.
- **Reliability:** National postal services are often considered to be less reliable than third-party logistics providers. E-commerce sellers need to be aware of the reliability of any service that they use.
- **Additional services:** Depending on the business model, different services may need to be added to the core transport module. E-commerce sellers must decide which added services, such as tracking and insurance, are crucial for their business and if they justify any extra costs.

⁶ Copenhagen Economics (2013). E-Commerce and delivery: A study of the state of play of EU parcel markets with particular emphasis on e-commerce. Commissioned by the European Commission.

⁷ A full list of post codes subject to 'remote area surcharges' (including in Central American countries) is available on logistics provider websites. For DHL, for example, see https://www.dhl.es/content/dam/downloads/g0/express/services/surcharges/dhl_express_remote_areas.pdf

Most logistics services firms provide a direct tool to calculate costs of services:

- United States Postal Service – <https://postcalc.usps.com/>
- UPS – <https://wwwapps.ups.com/ctc>
- FedEx – <https://www.fedex.com/ratefinder/home>

Incoterms define responsibilities in cross-border e-commerce

The first step for e-commerce sellers is to choose how they deal with trade compliance. However, they also need to decide if they or their customers pay customs duties and taxes, and how those payments are made. Understandably, buyers want to know the final cost – also known as the ‘landed cost’ – before they commit to buying goods, with all shipping costs, customs duties and taxes included. But it is often difficult for a seller to determine the landed cost of goods because customs duties and taxes vary from country to country.

Standardized terms, set by the International Chamber of Commerce, can help sellers tackle this challenge. Incoterms, derived from the phrase ‘international commercial terms’, outline the responsibility of each party, both seller and buyer, for the delivery of products under sales contracts. Incoterms are often used to describe who should pay duties and taxes, and who is responsible for shipping and insurance-related obligations.

Incoterms are widely used in commercial transactions, including for e-commerce, and help to avoid misunderstandings among traders. They are accepted worldwide. The last version of the Incoterms is from 2020. For e-commerce sellers using a third-party logistics provider for trade compliance and logistics, the DAP (delivered at place) Incoterm is usually applied as a default option. DAP is also known as DDU (delivery duty unpaid). The option of DDP (delivery duty paid) is also common among e-commerce sellers.

- DAP, which replaces the former DDU or DTU, means the seller is responsible for delivering the goods to the buyer. The seller bears all risks involved in bringing the goods to the destination.
- DDP means the seller delivers the goods when they are placed at the disposal of the buyer, cleared for import on the arriving means of transport ready for unloading at the named place of destination. The seller bears all the costs and risks involved in bringing the goods to the destination and is obliged to clear them for both export and import, to pay any duty for both export and import, and to carry out all customs formalities.

Every e-commerce seller and customer will somehow be confronted with Incoterms. Online sellers of goods must decide whether to pay duties and taxes themselves or let their customers pay. The most frequently used Incoterm is DAP, which means the customer is responsible for paying duties and taxes, and the seller deals with the costs and risks of bringing goods to the border, including transport.

Determining the amount of customs duties to be paid

Customs duties will need to be paid if the value of the shipped goods exceeds any exemptions for the payment of customs duty. For example, items with a value up to \$800 can be shipped duty-free to the United States. The European Union maintains a much lower threshold of €150 for products sent directly to the buyer.

When sellers outsource trade compliance to a customs broker or third-party logistics provider, the ‘default’ terms of trade (DAP Incoterm) mean the customs broker will need to collect payments from the customer, based on a calculation according to information on the pro forma or commercial invoice.

The following list provides guidance on the four basic steps to determine the correct customs payment for imports into foreign markets:

- **Step 1:** Verify classification and description of the goods in accordance with target market requirements.
- **Step 2:** Determine the applicable tariff for the product and target market, including possible exemptions and reductions for documentation and/or preferential duty rates under free trade agreements.
- **Step 3:** Calculate the correct customs value of the goods.
- **Step 4:** Sellers who want to trade their products under a preferential tariff must ensure that they meet origin conditions under the specific free trade agreement.

The following questions will help sellers prepare the information that must be provided to the customs broker:

- Have you provided a complete, accurate classification and description of your merchandise in accordance with target market requirements?
- Has the customs representative chosen the correct tariff rate for your merchandise, considering free trade agreements and possible exemptions and reductions?
- Has the correct customs value been calculated?
- Is there is an option to trade under an FTA between your domestic and target market and, if so, have you met origin conditions and provided an origin certificate, if needed, to the third-party logistics service provider?

Classification of goods: The starting point

The customs tariff is based on the customs classification code. Classification is not only used to determine the customs duty rate for a specific product, but also for applying non-tariff measures. For each international trade transaction, every item must be classified and identified for customs purposes, using an internationally recognized commodity code. The classification of goods is used to calculate the corresponding rates of customs duty, to apply for import or export licences, to find out if restrictions apply, to issue a certificate of origin, to determine if a reduced tax rate applies and other purposes.

The basis for classification of goods is the list of commodities developed by the World Customs Organization, the Harmonized System (HS), which identifies products based on a six-digit code.⁸ The HS was last reviewed in 2017⁹ and comprises about 5,300 article/product descriptions that appear as headings and subheadings, arranged in 99 chapters. Countries generally have a national tariff schedule, which contains six-digit numbers plus two or four additional numbers.

For example, the European Union maintains the Combined Nomenclature, which itemizes the HS list of commodities in more detail (eight digits), and the Integrated Tariff of the European Union (TARIC), which provides further information on all trade policy and tariff measures (10 digits). The United States maintains the Harmonized Tariff Schedule.¹⁰

Determining the applicable tariff rate

When goods surpass the threshold of duty-free entry, the right customs duty must be calculated. Each product line usually has several tariffs. E-commerce sellers must inform the customs broker (usually on the commercial invoice) if they wish to use a preferential tariff based on a free trade agreement.

Exporters should consider and compare the different tariffs. If it is very costly for a business to comply with the origin conditions of an FTA, the applied tariff may be the better option. Exporters must understand that knowing the correct customs tariff is not the same as knowing the full amount of customs duties to be paid (this requires additional calculations based on the customs value and the origin of the goods).

Three types of tariffs constitute the basic knowledge for determining customs duties:

- Bound tariff: Countries that are WTO Members promise not to exceed this 'ceiling' rate. It is the maximum most favoured nation (MFN) level for a given product, above which the WTO Member agrees not to raise its tariff.
- Applied or MFN tariff: This is the tariff a country imposes on imports. The applied rate can be below or at the same level as the final bound rates, but never above them. In other words, applied tariffs are what countries promise to apply on imports from other WTO Members if they are not in a customs union or do not have an FTA.

⁸ Although the HS specifies products using six digits, countries can add additional numbers to distinguish between different tariff lines.

⁹ A new version will be applicable from January 2022.

¹⁰ See detailed product codes for the European Union Combined Nomenclature at https://ec.europa.eu/taxation_customs/dds2/taric or search the United States Harmonized Tariff Schedule at <https://hts.usitc.gov/>.

- Preferential tariff: Trading partners can offer even better market access to each other through a customs union or an FTA. The preferential tariff can also be used for specific arrangements for developing countries. However, sellers usually need to comply with rules of origin to qualify for the preferential tariff.

Box 1 Classifying products in the European Union and United States

ITC trade tools are an indispensable source of information for any kind of market analysis research, including product codes and tariff lines or applicable tariffs. Use Market Access Map (www.macmap.org) to research customs tariffs (including tariff preferences) applied by more than 200 countries and faced by 239 countries. Use Trade Map (www.trademap.org) to research trade statistics. Many online courses are available to teach sellers the basics or refresh their knowledge.

Follow these steps to find the correct tariff line (HS code or national tariff line) in the Market Access Map, also known as MacMap:

- Select the importing country.
- Select the year for which you want to find applicable tariffs.
- Identify the product by typing the precise description in the selection menu. Note: the menu is set to HS6 codes by default; select the right option to see the national tariff line code.
- Select the exporting country.

Source: ITC Market Access Map.

Ensuring the correct customs value

The customs value of a product is needed to calculate import duties and taxes. Various rules apply regarding the determination of the customs value. Usually, however, the customs value is the price paid or payable for the goods when sold for export to the target market (import duties = customs value × import duty rate).

Box 2 Customs valuation of a handbag exported from Honduras to Germany

This example concerns the customs valuation for the import of a handmade leather bag, purchased under Incoterm DDP, from Honduras, unloaded in Antwerp, Belgium, and delivered in Germany. The goods are packaged in specific containers, for which the price is not included in the initial order and will be subject to separate invoicing.

Invoice value	€175
Maritime transport	Already included
Transport from Belgium to Germany	- €20
Packaging in specific containers	€12
Customs value	= €167

Note: Cost of transport up to the first point of entry in the European Union is to be added to the transaction value, but not the cost of transport after entry into the European Union. Hence, the cost of transport after the first point of entry in the EU customs territory is deducted from the transaction value.

Source: ITC.

Determining if a preferential tariff can be applied

E-commerce businesses selling products usually use two types of reductions and exemptions. For low-value goods, the available exemptions under de minimis thresholds may allow merchandise to enter duty-free and with simpler customs procedures. For goods that are worth more than the low-value threshold, there may be reduced import duties as a result of a free trade agreement between the country of origin, which is usually where products have been manufactured, and the country of destination, which is usually where they are used and consumed.¹¹

Some 290 FTAs are in force globally, providing for improved and reciprocal market access between two or more trading partners.¹² To take advantage of these accords, businesses must show that they comply with the conditions agreed under the FTA, which include 'origin' requirements.

Domestic rules or international trade agreements (such as FTAs) may generate reductions or exemptions that can decrease or eliminate import duties. Generally, the lower tariff can result in a competitive advantage.

If the preferential tariff under an FTA, such as the European Union–Central America Association Agreement, is lower than the applied (MFN) rate, sellers must ensure that they meet the origin conditions specified in the trade deal. The complexity of proving that they meet the FTA requirements may cause some businesses, especially micro, small and medium-sized firms, to choose the applied or MFN tariff.

Box 3 Free trade agreements in Central America

Countries in the Central America region have negotiated several FTAs among each other as a group, as part of the Central American Integration System. Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama created this system, with Belize and the Dominican Republic joining at a later stage. Multiple trade agreements have been signed between the group and economies such as the European Union and the United States.

A business must realize that there may be overlapping FTAs under which its trade could benefit from improved market access to target markets. Firms should make sure their customs brokers explore these options and inform them about the conditions. For example, while Costa Rica is part of the Central American Integration System group, it has also negotiated bilateral FTAs with, among others, Canada, Chile, China, Colombia, Mexico, Peru and Singapore. Entrepreneurs can check the available FTAs for their country in the WTO RTA Database.

For firms based in one of the Central American countries, targeting the European or US market can provide benefits under the FTA negotiated as a group. However, they should be aware that exporting to the European Union or the United States may involve different conditions under these FTAs.

Source: The WTO RTA Database.

Some FTAs include a dedicated commitment on e-commerce, to support trade over e-commerce platforms and target benefits for micro, small and medium-sized enterprises.

The European Union–Central America Association Agreement is a good example, and the recent United States–Mexico–Canada Agreement also provides an interesting perspective on how bilateral trade relations are used to stimulate e-commerce between countries or regions. For example, under the latter accord, the United States, Mexico and Canada agreed to promote e-commerce and increased the de minimis thresholds for trade between the countries.

¹¹ In the European Union, consignments below the value of €150 can be imported from a third country free of import duties (article 23, reg 1186/2009). See <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:324:0023:0057:EN:PDF>

¹² WTO.

Meeting origin conditions to take advantage of preferential tariffs

To benefit from improved market access and lower customs duties agreed under a free trade pact, a trader must prove that the product exported originates from an FTA party. In international trade, origin is the 'economic nationality' of goods traded.

In general, the country of origin of an item is the country where it is obtained, produced or has undergone sufficient processing. Claiming preferential origin on a product could lead to certain tariff benefits, such as entry at a reduced or zero rate of duty. The economic nationality of the product is not to be confused with the country of departure.

A product can originate in two ways:

- Where only one country is involved in the manufacture of materials and products ('wholly obtained');
- Being 'sufficiently transformed' (worked or processed) in the FTA partner country, incorporating products that have not been wholly obtained there. The level of sufficient 'working or processing' that is needed to obtain preferential origin for the final good is determined by the list rules¹³ in the origin protocol of the FTA.

If a product is not entirely produced in the FTA party (or parties), the trader needs to prove that it contains the minimum percentage of inputs and components according to the criteria set in the FTA. For example, if the general tolerance rule is 20%, the product should contain 80% of domestically manufactured or sourced products and no more than 20% of foreign content.

The rules of origin of an FTA are mostly specified in a separate 'origin protocol'. A company may need to apply for an origin certificate or statement of origin – which is mostly dealt with by a domestic institution in its home country – to prove that it meets the origin requirements of an FTA.

Unfortunately, every FTA has its own, unique origin rules. A firm must verify the specific conditions and demonstrate 'proof of origin' on customs documents even if an item was produced entirely in its home country. The ITC MacMap tool offers access to all the origin protocol documents that are annexed to FTAs.

¹³ List rules (also known as product-specific rules of origin) describe the working or processing that non-originating materials have to undergo for the final product to obtain preferential originating status.

Box 4 Understanding the origin conditions to benefit from preferential tariffs

E-commerce sellers must understand how they can meet the unique origin conditions under an FTA between their home market and the destination market. This case study examines the origin conditions of the European Union–Central America Association Agreement.

First, it is important to find out the general origin conditions under the FTA. The Origin Protocol of the European Union–Central America Association Agreement (Appendix 2 of the accord) consists of separate documents for each Central American member country. In general, exports can contain up to 10% of non-originating content to benefit from the preferential tariff under the FTA. This so-called general tolerance rule means that a maximum 10% of the value of the ex-works price of the product – where the seller is required to make the product available at a selected location while the buyer pays for transport – can be produced outside the Central American region.

Sellers must then determine if their product needs to meet the general conditions, or whether specific origin conditions may apply under the FTA.

The following questions and answers may be useful in preparing origin assessments:

Was the product made in Central America or does it qualify as 'originating' under the FTA?

Originating products are either wholly obtained in Central America, such as vegetables or live animals born there, or incorporate materials that have not been wholly obtained in Central America but have 'undergone sufficient working or processing in Central America'. A product that does not contain more than 10% of non-originating materials can still be tolerated as 'originating'. To document the goods as 'originating', supporting evidence should be provided (i.e. invoices of domestically bought and/or imported goods and ingredients).

Which documents can serve as proof of origin under the trade agreement?

To qualify for preferential duty rates at EU borders, goods originating in Central America must be accompanied by either 1) an invoice declaration, issued by any exporter, for consignments worth €6,000 or less, or by approved exporters, for consignments of any value, or 2) a movement certificate, issued by the competent authorities of the exporting country for consignments valued at €6,000 or more. The certificate remains valid for 12 months. The exporter (or authorized representative) applying for a certificate must be prepared to submit documents proving the originating status of the products concerned on request and fulfil the other requirements of the Origin Protocol.

How can I apply for a certificate of origin?

Firms should apply for a certificate of origin at a dedicated institution in the country of export. The Origin Protocol explains where a trader can obtain proof of origin. For example, in Panama, the Ministerio de Comercio e Industrias is responsible for issuing movement certificates and the Autoridad Nacional de Aduanas for verifying proofs of origin and granting the status of approved exporter.

How can I show proof of origin when asked to prove that the products originate in Central America?

Apart from the certificate of origin or invoice declaration, firms can provide direct evidence of the processes carried out by the exporter or supplier, such as accounting records, or documents proving the originating status, working or processing of materials used.

What other conditions apply to benefit from preferential tariffs under the FTA?

In addition to the certificate of origin, customs brokers or third-party logistics providers may require evidence of 'direct transport'. This means the product was sent from the originating country and arrived in the European Union without being manipulated in another country.

What does it mean if my product classification code is listed in Appendix 2, with product 'list rules' that specify the sufficient working or processing required on non-originating materials so the product can obtain originating status?

This means your product does not keep to the general origin rule. For example, imitation jewellery (HS 7117) is part of the 'list rules' or product-specific rules. As shown in the Origin Protocol of the FTA, the product 'imitation jewellery' can still be originating if the value of all materials used does not exceed 50% of the ex-works price of the product. This is 40% more than the standard rule of 10% non-originating value.

How can I calculate the maximum amount of non-originating products for imitation jewellery (HS 7117) that I can use to benefit from preferential tariffs under the FTA?

The rule for imitation jewellery (HS 7117) is a mixed rule that requires manufacture from materials of any heading, except that of the product or manufacture from base metal parts, not plated or covered with precious metals, provided that the value of all the materials used does not exceed 50% of the ex-works price of the product. The manufacturer uses non-plated base metal parts (value €2), which are non-originating materials. Therefore, the manufacturer exports imitation jewellery (ex-works price €6) to the European Union as originating in Honduras, as the value of non-originating materials is less than 50% of the ex-works price of the product.

Source: ITC.

Taking advantage of exemptions for low-value-goods

Many governments have introduced exemptions to the payment of VAT and customs duties, including to reduce costs and burdensome administrative procedures for smaller businesses. More specifically, companies trading low-value export consignments can take advantage of de minimis regimes that aim to facilitate trade by simplifying border procedures. The International Chamber of Commerce defines de minimis as a valuation ceiling for goods, including documents and trade samples, below which no duty or tax is charged.

Under de minimis, clearance procedures (including data requirements) are also supposed to be simpler and less time-consuming to simplify the clearance of low-value goods.¹⁴ De minimis exemptions have proven particularly relevant in the context of e-commerce sales, which are typically business-to-consumer and involve many micro, small and medium-sized firms selling often low-value items.

Traders should understand that countries generally set different thresholds at which a person is liable for customs duties and/or value-added taxes. In addition to de minimis thresholds for low-value consignments on customs duties and VAT, there are also other exemptions (such as related to small gifts or commercial samples). On the other hand, some goods may not qualify for de minimis regimes (such as excise goods, which in most countries include at least alcohol or tobacco products).

Unfortunately, governments have not agreed on a single global de minimis value. Under the WCO revised Kyoto Convention, customs administrations shall specify a minimum value or minimum amount of duties and taxes below which no duties and taxes will be collected.

As previously mentioned, goods worth no more than €150 are exempt from customs duties at import in the EU, though the VAT exemption no longer exists (as of July 2021). The United States, on the other hand, maintains a de minimis threshold of \$800 for customs duties, but has no sales tax de minimis threshold.

The WCO includes a more elaborate overview of the de minimis regimes of its members in its 2017 report on e-commerce.¹⁵

Table 2 Overview of de minimis thresholds in three countries

Country	Customs duty de minimis	Taxes (VAT) de minimis	Gift	Commercial samples	Customs procedures; simplified declaration	Goods exempted from de minimis threshold
Netherlands (European Union)	€150	Above €22 (not applicable after 1 July 2021)	€45	Defined by regulation as negligible value	Not in use	N/A
United States	De minimis \$800 (set in the U.S. Trade Enforcement and Trade Facilitation Act of 2015)	N/A	\$100 or \$200 if from insular possession	N/A	N/A	Excise goods and other items ¹⁶
Switzerland	5 CHF	5 CHF**	300 CHF	100 CHF	≤ 1,000 CHF and ≤ 1,000 kg	Goods brought in by tourists

Source: ITC.

¹⁴ See International Chamber of Commerce, policy statement on 'Global baseline de minimis value thresholds', 2015.

¹⁵ See <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/activities-and-programmes/ecommerce/wco-study-report-on-e-commerce.pdf?la=en>

¹⁶ Alcoholic beverages, perfumes that contain alcohol, cigars, cigarettes, goods subject to US Partner Government Agency (i.e. US government agencies for which US Customs and Border Protection implements laws and regulations at the border) requirements.

Case study – calculating duties on Guatemalan purses delivered to a German buyer

An exporting company in Guatemala sells leather handbags through its own website. A customer in Germany has ordered three bags worth a total of €650. The products are sold under the DAP Incoterm (duties and taxes unpaid) and the customs broker takes care of trade compliance. However, the customer has asked for an estimate of the customs duties to be paid upon importation.

The three bags were partly produced in Guatemala. The leather comes from neighbouring country Belize and represents about 50% of the value of the bags. To calculate the customs duties, the e-seller should investigate the applicable tariff rates and explore the possibility of using the preferential (FTA) tariff under the European Union–Central America Association Agreement.

To determine the amount of customs duties due upon import of the goods, the following steps must be taken:

- Ensure correct product classification and description: Using the European Union Export Helpdesk tool, the product is classified under the following TARIC code: 42 02 21 00 10. The TARIC database also provides the correct description, to be used in the commercial invoice: 'Handmade handbags, whether or not with shoulder strap, including those without handle, with outer surface of leather.'
- Determine the applicable tariff for the product and target market, including possible exemptions and reductions for documentation and/or preferential duty rates under FTAs. The total value of the shipment must not exceed the €150 de minimis threshold to qualify for the low-value goods exemption. The most favoured nation or applied tariff is 3%.
- Under the European Union–Central America Association Agreement, a zero tariff will apply if the goods meet the origin requirements. The purses were not entirely produced in Guatemala, so they risk not qualifying as 'originating'. The Origin Protocol stipulates a maximum 10% tolerance rule, which means the handbags are not 'wholly obtained'. The seller tells the customer and the customs broker about the 'safe' MFN or applied tariff of 3% and calculates the estimated customs duty on this basis.
- Calculate the correct customs value of the goods. The value of the three leather bags to be imported is €650, including the maritime transport to the port in Germany but excluding transport costs from the port to the client. Additional packaging costs are €50. Hence, the customs value is €700 (calculating the packaging, but not the internal transport in the European Union after arrival).
- Calculate the amount of customs duties to be charged. Import duties = customs value × import duty rate.

Table 3 Steps to calculate customs duties

Customs duties calculation	Amount
Customs value	€700
Customs duty based on applicable tariff rate 3% (applied MFN or applied tariff) × customs value	€19.50
Total costs including customs duties (excluding VAT and customs broker administrative charges)	€719.50

Source: ITC.

In summary, customs clearance procedures are unique in each target market. The customs process demands that both the seller and the customs representative have responsibilities in the e-commerce supply chain. Sellers should be aware of relevant obligations to ensure that all information related to their package complies with domestic rules and procedures and is provided to the customs broker.

Three key elements must accompany the e-commerce shipment to a foreign market: classification and description of the goods, the applicable customs duty rate, including exemptions where applicable, and calculation of the actual duty amounts to be included in the invoice based on the customs value. The amount of customs duties to be paid depends on the classification and applicable tariff of the goods. However, reductions and exemptions in e-commerce are available if sellers meet certain conditions.

Some countries offer exemptions when the value of the goods is below a certain de minimis threshold, also referred to as the low-value consignment rule. Trade deals between the country of origin (usually where goods have been manufactured) and the country of destination (usually where the goods are delivered and used/consumed) could allow for a lower or zero tariff rate. Conditions must be met to benefit from the preferential tariff under the FTA.

Chapter 3

Understanding consumption taxes

E-commerce sellers across the world deal with different systems for consumption taxes, which are usually imposed on taxable sales by all sellers in each stage of the supply chain. For traders selling goods on the internet, it is important to keep track of the type of system (VAT, sales tax), the applicable rates and possible changes in legislation.

End consumers usually pay indirect taxes

Consumption taxes such as value-added tax (applied in the European Union and many other countries), or sales tax (applied in the United States as well as Australia, Canada, Malaysia and New Zealand) and excise duties are often categorized as indirect taxes. This is because they are not directly imposed on the person who is supposed to bear the burden of the tax, but rather on certain transactions, products or events and ultimately borne by the end consumer.

This section guides e-commerce businesses through the VAT process in the European Union and the sales tax process in the United States.

Consumption tax systems differ

Customs administrations collect customs duties directly, while sellers (suppliers, manufacturers, distributors and retailers) collect value-added tax and then transfer it to tax administrations. The VAT burden should generally rest on the final consumer, not on the business.

The systems for indirect taxes on consumption and/or sales differ from each other. This means the consequences of these taxes vary for traders selling goods through e-commerce platforms targeting customers in different destination markets.

VAT in the European Union is collected in a 'staged approach'. Usually, the trader charges the tax through an invoice credit method, which is transaction based, and the consumer receives an invoice showing the amount of VAT charged for a specific product. End consumers, suppliers, manufacturers, distributors or retailers pay the tax on their purchases and receive a credit for it through their VAT return, if the goods are resold. This is why it is important for businesses to track and document the VAT they pay on all purchases.

From July 2021, the European Union will implement a new VAT system that will bring substantial changes for non-EU sellers of goods on e-commerce platforms targeting customers in the bloc. The new rules aim at 'simplifying VAT obligations for companies carrying out cross-border sales of goods or services (mainly online) to final consumers and to ensure that VAT on such supplies is paid correctly to the member state of the customer'.¹⁷

Three different types of tax rates

The system of consumption taxes in the United States is based on a retail sales tax. Unlike VAT, sales tax is charged only once on goods at the last point of sale. This means that, in principle, only consumers are charged the tax and resellers are exempt if they are not the end users of the product. Sales tax is imposed and administered at state and local levels, not the national or federal level, adding to the complexity for non-US sellers.

¹⁷ See

<https://globaltaxnews.eu.com/news/2020-6264-european-commission-publishes-explanatory-notes-on-new-vat-e-commerce-rules>

Standard and reduced tax rates vary widely in worldwide markets. This means the already limited capacity of micro, small and medium-sized enterprises to trade is disproportionately affected by the efforts needed to comply with different fiscal frameworks in target markets.

The standard tax rate applies to most taxable goods and services traded. Reduced tax rates apply for certain products and services, including essential items such as food or medicines. Exemptions from tax payment apply for certain goods, services and types of transactions, such as low-value goods under a certain threshold benefiting from de minimis exemptions.

Many countries have exemptions to the payment of taxes. These exemptions can allow companies that trade low-value export consignments to take advantage of the de minimis regime, whereby no indirect taxes are collected. However, some countries limit the type of tax exemptions available to sellers – mostly micro, small and medium-sized enterprises – of low-value consignments.

The value-added tax system in the European Union

The European Union has one VAT system in the internal market. Even though EU members follow the same bloc-wide VAT principles, the detailed rules – including on value-added tax rates – differ from country to country.

The VAT system in the bloc is continually developing. Substantial changes approved in December 2017 come into force in July 2021, supporting a transition towards a fully modernized VAT system. This publication follows these new rules.¹⁸

Who pays value-added tax on imports?

VAT responsibilities for non-EU sellers are two-fold. Import VAT must be paid for each consignment imported into the EU, while periodic VAT returns need to be filed in case annual sales exceed a certain threshold.

Businesses can take up these responsibilities themselves or outsource some or all of them to a logistics service provider or custom broker. Outsourcing requires the payment of additional fees as well as a (thoroughly reviewed) agreement on the division of tasks and responsibilities in case issues arise. Finally, the new EU rules also oblige online marketplaces to collect and pay import VAT for shipments worth €150 or less.

The new rules eliminate the VAT exemption for imports below the €22 threshold. This means that all goods bought online by EU consumers from sellers outside the bloc will be subject to VAT. Shipments that enter the bloc from outside may still be exempted for customs duties under the de minimis customs duty relief for low-value goods (up to the value of €150).

¹⁸ The new EU VAT system rules and procedures are laid down in the Council Directive (EU) 2017/2455 of 5 December 2017, and the Council implementing regulation EU 2019/2026 of 21 November 2019. News and updates regarding the modernized EU VAT e-commerce rules can be consulted through the European Commission DG Taxud [website](#).

What else will change from July 2021?¹⁹

The following changes are planned:²⁰

- For consumers and businesses, the new rules mean that buying and selling goods across borders online will become easier. Registration and other VAT obligations on imports can be dealt with through the VAT online system, known as Import One-Stop Shop (IOSS).
- IOSS can be used for goods worth up to €150 that are imported from third countries or territories and sold to customers in the European Union. In such cases, the supplier will be obliged to charge and collect VAT when selling goods to EU customers and pay this tax through the IOSS to the member state where it is VAT registered. The tax has to be collected using the VAT rates applicable in the member state of the customer. The goods will then be exempt from value-added tax at the point of import between European Union states – meaning VAT is only collected once.
- VAT registration will only be required in one European Union member state.
- The new rules mean online marketplaces are responsible for ensuring VAT is collected on sales on their platforms that are made by companies in non-EU countries to European Union consumers. This includes sales of goods that are already being stored by non-European Union companies in fulfilment centers in the bloc.
- As already mentioned, online marketplaces are responsible for collecting VAT only on low-value goods. As a result, e-commerce businesses selling through online marketplaces, such as Amazon or Etsy, from outside the European Union, may not need to register for VAT and can rely on the online platform to handle all VAT obligations. Sellers also must agree with the platform on the documentation needed for them to comply with their reporting requirements.
- The European Union will remove the current VAT de minimis exemption for low-value goods with a value of up to €22.

Who must register to pay import VAT in the European Union?

Non-EU firms that sell goods to consumers in the bloc directly are advised – not obliged – to register in the IOSS for value-added tax. The IOSS system enables payments of import VAT and serves as a platform to file periodic VAT returns.

Registration is not required if selling through an online platform or courier. Under the new rules, an online platform or intermediary couriers and customs brokers may take up the responsibility to pay import VAT on behalf of the non-EU seller. If the seller is not registered in the IOSS, the buyer can also pay the VAT and the transporter usually charges a customs clearance fee.

The IOSS covers consignments with a value up to €150, even if the order contains more than one item. Goods subject to excise duties (alcohol and tobacco) are not covered under the IOSS.

From 1 July 2021, non-EU sellers become liable for periodic VAT payments (in one or more EU countries) if they store goods in fulfilment centres. A business that has established a local presence in the European Union will be considered liable for VAT, but will only need to register and pay the tax once its revenue reaches

¹⁹ For the latest information on VAT for e-commerce in the European Union see: https://ec.europa.eu/taxation_customs/business/vat/vat-e-commerce_en

²⁰ For a summary of the VAT e-commerce package, see https://ec.europa.eu/taxation_customs/business/VAT/digital-single-market-modernising-VAT-cross-border-ecommerce_en. On 8 May 2020, because of the practical difficulties created by lockdown measures taken to contain the coronavirus pandemic, the European Commission proposed to postpone the introduction of the new e-commerce VAT rules by six months. As adopted by the Council, the rules will apply as of 1 July, giving member states and businesses enough time to prepare.

a certain registration threshold. This threshold differs by country and, generally, there are special thresholds for small enterprises.²¹

For instance, all companies in Spain, regardless of their revenue, must register and pay value-added tax. Estonia, on the other hand, recently increased its VAT registration threshold from €16,000 to €40,000 to support smaller businesses.

Where to pay value-added tax?

Import VAT is paid in the European Union member state where the final customer is located. This differs from customs duties, which are paid in the country where the goods are customs cleared and where they are put into free circulation in the EU market.

How to pay value-added tax?

Starting in July 2021, VAT registration and payment can be done through the IOSS, requiring just one VAT registration and payment for all European Union distance sales up to a value of €150.

There are three options to pay and fulfil VAT obligations as a non-EU e-commerce business selling to customers in the bloc: directly through registration in the IOSS system, indirectly through a customs broker or logistics service provider, or through the online marketplace where the products are sold. The three options are explained below.

- **Option 1** – direct VAT payment. Registration in the IOSS system simplifies filing for VAT purposes, both for transactional payments (per package delivered in the EU) and regular VAT filing (on a monthly basis). If the e-commerce seller or online marketplace has not registered in the system, packages can be delivered to the customer after the courier collects the VAT from the customer (and pays it to the customs authorities), or if the customer pays the tax to the authorities directly.

Registration in the IOSS for regular VAT filing is only required with the tax authority of one EU member state. The system will allow the filing of a regular domestic VAT return (required in at least one EU member state) through monthly VAT filing. This practice for non-EU sellers will be the same as for sellers based in the bloc. As a non-EU taxpayer, it must be done via an intermediary established in that member state.

- **Option 2** – indirect, outsourced trade compliance through the customs broker. Under the new rules, postal operators and couriers will be able to declare goods for VAT purposes in the EU member state of consumption.
- **Option 3** – indirect, through the online marketplace that is registered with IOSS. When an online marketplace ‘facilitates’ goods sold to an EU customer and the consignment value is less than €150, the marketplace will pay the VAT collected on a sale to a buyer in the EU.²² Online marketplaces cannot collect or pay VAT for consignments above €150. The VAT rate of the country where the goods are to be delivered will be applied.

The online marketplace will also submit an electronic monthly VAT return via the IOSS portal of the EU member state where it is registered. This means that, during the ordering process, online marketplaces will inform buyers about the amount of VAT to be paid by the buyer in the EU.

Non-EU sellers who choose to register in the IOSS for VAT purposes enjoy two benefits. First, the IOSS allows suppliers and electronic interfaces selling goods in the European Union to collect, declare and pay VAT to the tax authorities, instead of making the buyer pay the tax when the goods are imported into the EU

²¹ https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_in_ec_annexi.pdf

²² If a buyer purchases several items from the same seller and these goods are shipped in a package valued at more than €150, the goods must be taxed at importation in the EU member state, for example, through the customs broker or directly by the seller or buyer.

(as was previously the case for products worth more than €22). Second, registration in only one EU member state is needed, and this is valid across the bloc.

How much tax to pay?

The amount of VAT to be paid for packages sent from outside the European Union depends mainly on the location of the customer. The rate is the one applicable in the country where the goods are to be delivered.

VAT rates can vary across EU member states. According to EU law, member states have a certain flexibility to set their own rates, but a standard rate of at least 15% and a reduced rate of at least 5% must be applied.

Online sellers should keep track of VAT rates in different EU countries. The list of rates can be found on the European Commission website.²³

The sales tax system in the United States

In the United States, a sales tax 'nexus' or economic presence is the underlying principle determining whether sellers must collect and pay sales taxes. A sales tax nexus used to be linked to sellers with a physical presence in a state, but some states now have nexus laws affecting remote sellers, including those that operate online. Customs brokers will be able to advise if, as a seller, a company is obliged to charge and pay sales taxes.

Who must register to pay sales tax?

A non-US firm must register for sales tax only if it has an economic presence in certain states. If a business has no nexus, there is no need to register for a sales tax permit or collect sales tax from customers.

A company that meets the criteria for nexus in a US state must register for a state sales tax permit and collect sales tax from all buyers in that state. This may also mean that the company needs an Individual Taxpayer Identification Number to register for a permit. Furthermore, it may have to open a United States bank account, as many states only accept sales tax payments using transfers from a domestic bank. In this case, using a local sales tax expert may be advisable.

Where to pay sales tax?

The customs broker will calculate sales tax and collect it from buyers. The tax is charged only once on goods at the last point of sale to the end user and is paid in states where the seller has an obligation to pay.

How to pay sales tax?

If a business has a sales tax nexus in certain states, it must register with the state, submit the relevant documents to the tax authority, and collect and pay sales tax to ensure compliance. Customs brokers will be able to help with these matters.

To determine the specific criteria for sales tax nexus obligations in US states, use the Nexus Assessment Tool from Avalara at www.avalara.com.

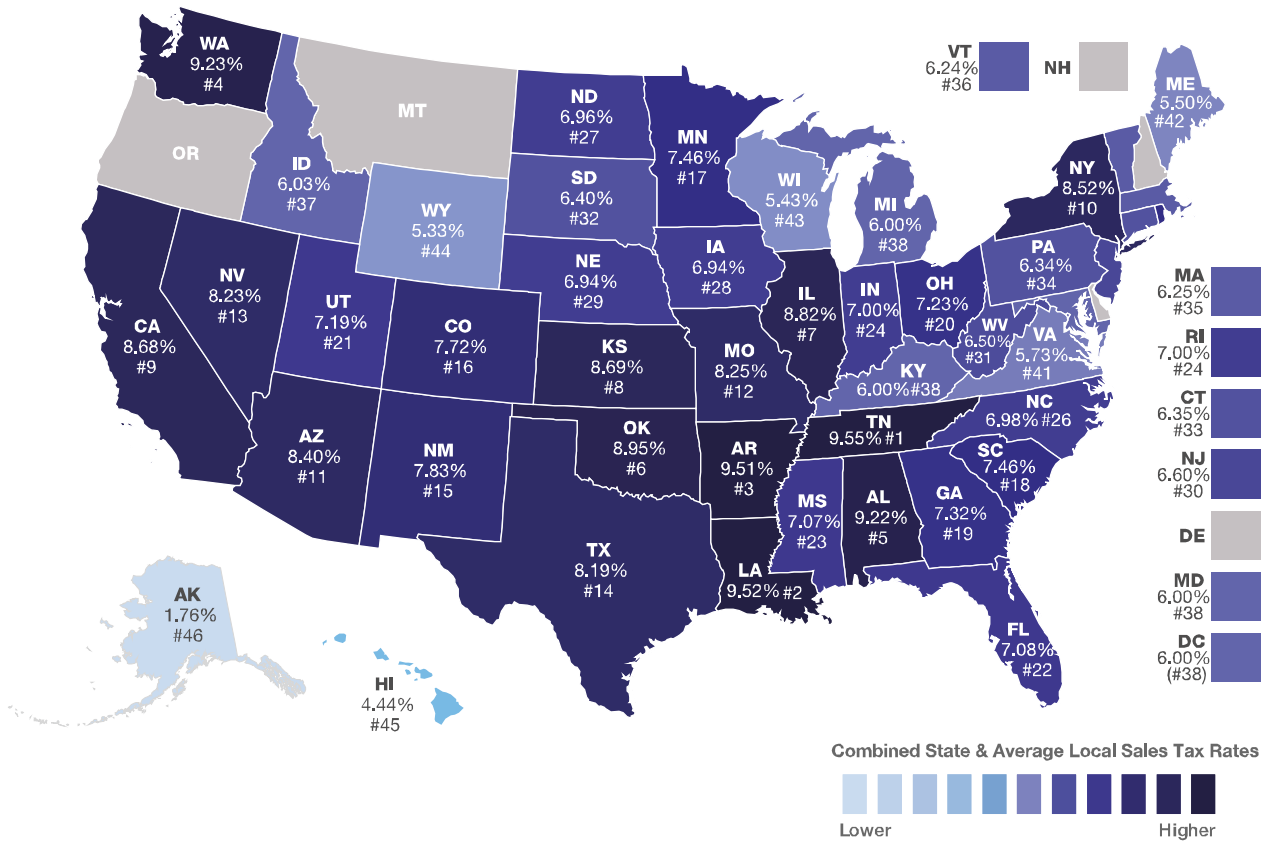
How much sales tax to pay?

The amount of sales tax to be paid depends on several factors, including the destination state and the type and value of goods or services traded. Customs brokers will calculate sales tax rates.

²³ https://ec.europa.eu/taxation_customs/tedb/vatSearchForm.html

Currently, 45 of the 50 states impose broad-based sales taxes, and 38 collect local sales taxes. The combined state and local sales tax rates vary widely in the United States. Overall, sales tax rates are much lower than the comparable VAT rates in the European Union. The figure below shows combined state and average local sales tax rates in the United States, as of 1 January 2021.

Figure 3 Tennessee and Louisiana have the highest sales tax rates



Source: Tax Foundation, 2021.

What exemptions are available?

The United States offers no exemptions for the payment of sales taxes at federal or local state level. However, the country continues to maintain one of the most attractive de minimis regimes for non-US sellers through its import duty and tax exemptions. These benefit many micro, small and medium-sized enterprises from developing economies and other third countries.

Case study – calculating VAT on Guatemalan purses shipped to Germany

The customs broker of a business selling through e-commerce channels will collect import taxes and customs duties from the customer if goods are sold under the DAP or DTU Incoterm, or directly from the business if goods are sold under the DDP Incoterm (delivered duty paid). When a non-European Union firm targets the EU market, VAT is, in principle, charged to the customer unless an exemption applies.

The procedure for paying import VAT is usually dealt with in the same way as for customs duties. However, customs duties are paid when the goods are released for circulation, while VAT is paid when the goods are released for consumption.

Continuing the earlier example of an exporting company in Guatemala selling leather handbags to Germany with a total value of €650, sold under the DAP Incoterm; to calculate the amount of VAT due when the bags are imported, the following steps must be taken:

- Ensure correct product classification and description. Using the European Union Export Helpdesk tool, the product is classified under the following TARIC code: 42 02 21 00 10. The TARIC database also provides the correct description, to be used on the commercial invoice: 'Handmade handbags, whether or not with shoulder strap, including those without handle, with outer surface of leather.'
- Determine the rate of import VAT and possible exemptions for VAT payment. The applicable standard value-added tax rate in Germany is 19%.
- Calculate the correct customs value of the purses. The value of the three bags to be imported is €650, including the maritime transport to the port in Germany but excluding transport costs from the port to the client. Additional packaging costs are €50. Hence, the customs value is €700.
- Determine the applicable customs duty tariff for the product and target market, including possible exemptions and reductions, and/or preferential duty rates under FTAs. The total value of the shipment exceeds the €150 de minimis threshold for customs duty exemption. The goods will not qualify for the preferential (0%) import tariff under the European Union–Central America Association Agreement. The most favoured nation or applied tariff is 3%. The estimated customs duty is calculated using this tariff.
- Calculate the amount of customs duties to be charged, based on the applicable tariff rate: import duties = customs value × import duty rate. Based on the 3% tariff rate, the customs duties to be paid will be €19.50.
- Determine the correct amount of import VAT to be paid on the goods. The transaction value of the leather bags is €650. To calculate the import VAT, the following must be added: value for customs purposes + customs duties and any other import taxes + supplementary costs up to the place of destination. The calculation of VAT to be included on the import declaration, invoice and to be collected from the customer is: €749.50 × 19% = €142.41.
- Calculate the additional administrative charges on customs duties and VAT, charged by the customs broker or third-party logistics provider. Total customs duties and VAT charges: €161.90 × 2.5% = €4.03.
- Inform the customer about the estimated total price of the products. First, as a result of your calculations, you can now inform the customer about the estimated additional €19.50 for customs duties (3%) and €142.40 for VAT charges (19%), as well as €4.05 for customs broker 'administrative handling' charges (2.5% on customs duties and VAT amount).
- Hence, including all charges, the final cost will be €895.95, of which €650 is the transaction value of the goods and €245.95 are additional charges. The customs broker will communicate the final cost only once it has been approved by the customs administration.

Table 4 Steps to calculate value-added taxes and customs duties

VAT and customs duties calculation	Amount
Customs value, including transport to the port in Germany	€700
Customs duty based on applicable tariff rate 3% (applied MFN or applied tariff) × customs value	€19.50
Supplementary costs to the place of destination (transport from port to customer)	€30
Total	€749.50
VAT 19% of total	€142.41
Total	€891.91
Supplementary 'administrative handling charges' by the customs broker of 2.5% charged on customs duties and VAT amount (€161.90)	€4.03
Total cost of package and delivery for customer	€895.94
Estimated total charges to be paid by the customer on top of the transaction value (€650)	€245.94

Source: ITC.

Recommendations for sellers

Businesses that sell goods over the internet have access to a global consumer base. However, they also face the challenge of ensuring trade compliance relating to customs duties and indirect taxes, which can vary in different target markets.

The following recommendations will help e-commerce sellers who choose to outsource trade compliance to a third-party logistics provider:

- Ensure in-house understanding of key principles of the customs process, including paperwork requirements, customs duties and indirect taxes. Ensure access to basic information to improve awareness and knowledge of customs duties, VAT/sales tax rules and procedures relevant to the most important target markets to minimize the risk of non-compliance.
- Analyse the trade transactions of your business, particularly in relation to target markets and most traded products, as a basis for targeted information gathering on market- and product-specific requirements.
- Make sure the necessary in-house trade compliance processes are in place, even when trade compliance is outsourced.
- Have an overview of the necessary export and import documents required for customs clearance for the three to five most important target markets.
- Ensure the correct product description and classification of the three to five most traded products, including HS codes and national tariff lines, for your most important target markets.
- Compile an overview of relevant low-value goods exemptions and available FTAs.
- For your best-selling products, make sure you fully understand and comply with national and regional (if necessary) technical product, safety and labelling standards.
- Review the cooperation and performance of your third-party logistics provider or customs broker at regular intervals and request updates on trade compliance performance. If you are subject to penalties or fines, address the causes.
- Keep a detailed record of all trade transactions and proof of evidence. Ensure that you have records of relevant documents, such as invoices, packing lists, country of origin certificates, accounts payable and receivable, purchase orders, sales records and correspondence files.
- Consider options and costs for automating documents relating to trade compliance, record-keeping and interaction with the third-party logistics provider or customs broker.

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