

(Preliminary Draft) Practical Guidance on Free Zones

WCO Members and observers wishing to contribute to this draft Guidance are invited to send their national experiences and/or provide comments to the WCO Secretariat (satoko.kagawa@wcoomd.org) by 7 January 2020, at the latest.



WORLD CUSTOMS ORGANIZATION

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I. Introduction

1. Background

- 1.1 The number of Free Zones (FZs) in the world is thought to amount to thousands and to be increasing. The International Labour Organization (ILO) (2014) reported that there were more than 3,500 'export processing zones' in the world as of 2014, and The Economist (2015) stated that there were 4,300 'free trade zones' as of 2015. The WCO online survey, conducted in 2018 with 61 WCO Member respondents, showed that the number of Free Zones adds up to over 2,300 in respondents' countries.
- 1.2 The establishment and operation of FZs, typically accompanied by economic incentives including limited regulatory oversight of goods, special arrangements for Customs and other duties, and regulatory exemptions, have played an important part in the economic/industrial development policy of many countries. The rapid expansion of FZs has been mainly driven by political decisions closely affiliated with national economic development strategies.
- 1.3 However, it has been pointed out in existing literature that FZs attract not only legitimate business but also illicit activities that take advantage of regulatory exemptions in FZs and also the lack of oversight therein. Numerous papers¹ have dealt with illicit activities perpetrated by exploiting the characteristics of FZs. Such illicit activities include money laundering, tax evasion and trade in counterfeit goods or other illicit goods such as drugs, weapons, cultural heritage, fake medicines and even environmental waste.
- 1.4 As McKinsey & Company (2019) have warned, ill-conceived or poorly implemented FZs can have a significant negative impact on FZs' competitiveness. Controlling illegal trade in FZs contributes to improving the business environment and competitiveness of FZs, as well as to meeting the United Nations' Sustainable Development Goals, such as Goal 3 (Good Health and Well-Being), Goal 8 (Decent Work and Economic Growth) and Goal 16 (Peace, Justice and Strong Institutions), and to enhancing the social responsibility of companies and governments.
- 1.5 Accordingly, many papers² such as the FATF (2010), the ICC (2013), the Interpol (2013), Viski et al.(2016), The Economist (2018), the OECD (2018), and McKinsey & Company (2019) have urgently called for high levels of control over goods and activities inside FZs. Some have also stressed the needs of Customs' involvement and empowerment of Customs to control goods and activities inside FZs.
- 1.6 Furthermore, during the WCO workshops conducted in 2018/2019, it was repeatedly mentioned by FZ operating bodies and the private sector that if Customs were to become more involved in FZs, then FZs would be more likely to be competitive and succeed. Customs can play a significant role in contributing to the healthy and sustainable economic development of FZs by participating not only as a law enforcement agency but as a trade facilitator (McKinsey & Company (2019)).
- 1.7 Since 2008, the series of discussions have been conducted in the World Customs Organization (WCO) which did raise awareness of illegal activities conducted in FZs; however, a concrete conclusion could not be reached due to the difficulties of changing already established FZ regimes to ensure adequate Customs procedures/control, by influencing policy-makers. Nevertheless, through such

¹ The papers are referenced in the after-mentioned WCO Research Paper No.47.

² Id.

discussions, more and more Customs administrations have expressed the need for better Customs procedures/control in FZs while effectively contributing to the competitiveness of FZs.

- 1.8 In December 2016, the WCO consequently included FZs as an essential topic in the WCO Economic Competitiveness Package (ECP)'s Action Plan with the aim of developing possible guidance to ensure adequate Customs control in FZs, while supporting healthy expansion of FZs.
- 1.9 The Permanent Technical Committee (PTC) (219th/220th Sessions), the Enforcement Committee (EC) (37th Session) and the Policy Commission (December 2018 Session) held intensive discussions on FZs and agreed to produce a study report and guidance materials based on an analysis of the current situation (including the economic benefits of FZs) and possible solutions through an online survey, field studies and workshops.

2. WCO Research Paper on Free Zones

- 2.1 In accordance with the WCO ECP action plan, the WCO Secretariat conducted research on the current situation related to FZs including a literature review, an analysis of the online survey on FZs in 2018, and workshops and field studies in six WCO regions during financial year 2018/2019, the results of which were analysed in WCO Research Paper No.47: "‘Extraterritoriality’ of Free Zones: The necessity for enhanced Customs involvement".
- 2.2 The FZ Research Paper:
 - outlines the definitions, characteristics and economic benefits of FZs;
 - addresses the risks posed by FZs, which primarily relate to illicit activities perpetrated by exploiting FZs, such as illicit trade or money laundering, and describes their global and interregional nature;
 - describes the perceived ‘extraterritoriality’ of FZs, which is a misinterpretation of the definition under the Revised Kyoto Convention (RKC), and then outlines the resulting limited involvement by Customs in the operation of FZs and Customs insufficient authority; and
 - explains that, within the meaning of the definition of FZs under the RKC, ‘goods’ located in FZs are considered as being outside the Customs territory only for the purpose of applying duty/tax and that an FZ itself forms part of the Customs territory.
- 2.3 The FZ Research Paper can be accessed by the public at:

http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/47_free_zones_customs_involvement_omi_en.pdf?la=en

3. Objectives

- 3.1 The objective of the Guidance is, firstly, to raise awareness of the challenges faced by Customs and the private sector based on the findings and analysis of WCO Research Paper No.47. It also aims to share a range of best practices by Member Customs administrations, collected through WCO online survey on FZs in 2018 and the WCO workshops conducted during financial year 2018/2019, in order to support Customs in enhancing the Customs procedures/control to be applied in FZs while effectively support the healthy development and competitiveness of FZs.

3.2 Based on an analysis of the Research Paper, this Guidance follows up on each of the key findings so as to provide practical guidance derived from Members' best practices. The practical guidance in each chapter have also been listed under the Checklist in Annex III to this Guidance.

4. Implementation

4.1 It is clear that WCO Members will face certain challenges in implementing this Guidance in their countries: many Members understand the difficulties in changing already established FZ regimes to ensure adequate Customs procedures/control, by influencing policy-makers.

4.2 However one thing is certain; as stressed in many academic papers, the need for a high degree of Customs involvement and better Customs control and facilitation of goods and activities inside FZs is widely recognized and highlighted. There is a critical need to ensure that the operational environment of FZs is safe and secure, procedures are efficient and transparent, operators are law abiding, and commodities entering and passing through the FZs are legal. It is Customs' responsibility to ensure all of the above.

4.3 Now is the time to raise the profile of Customs administrations as major players in securing trade in FZs as well as contributing to sustainable development of FZs. As more WCO Members develop robust Customs regimes in their FZs, other WCO Members are likely to follow. Even though FZs are set up under national development policies, the current situation goes beyond ownership of FZs by individual countries as the impact of criminal activities in FZs is being felt worldwide. Accordingly, proper Customs procedures/control in FZs are issues not only for countries maintaining FZs, but also for those without them.

4.4 In order to develop robust Customs regimes in FZs, coordination among relevant governmental bodies and policy dialogue are essential. One possible approach towards implementing this Guidance could be to conduct a pilot project with a national implementation plan among all FZ-related authorities.

4.5 Recognizing the significant role that Customs can play for healthy and sustainable economic growth of FZs, it is essential for Customs to participate in all stages of their implementation and not only for compliance purposes but also to facilitate trade.

II. Executive Summary of the Guidance
(TO BE ADDED IN THE FINAL VERSION OF THE GUIDANCE)

DRAFT

III. Guidance on FZs

1. Territoriality aspect of FZs

Are FZs outside or inside the Customs territory?

Explanation

- 1.1 The territorial definition of FZs is the core issue to be resolved in order to enhance Customs involvement and procedures in FZs, as it significantly affects the applicability of Customs procedures and controls and also defines the role of Customs in FZs.
- 1.2 Chapter 2 of Annex D to the RKC defines a FZ as :
- “a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory.”*
- The RKC also defines “Customs territory” as the territory in which the Customs law of a Contracting Party applies (E12/F25, Definition, Chapter 2 of the General Annex to the RKC).
- 1.3 As pointed out in the WCO Research Paper, this definition in the RKC does not state that FZs are geographically outside the Customs territory. In fact, the definition means that a FZ itself falls within the Customs territory. “Goods” located in FZs are considered as being outside the Customs territory only for duty/tax purposes.
- 1.4 However, owing to the main characteristics of FZs, such as duty/tax exemption without actual exportation abroad and without provision of financial security, some countries regard the FZ itself as “being outside the Customs territory”. Consequently, the concept of FZs’ ‘extraterritoriality’ from the Customs territory seems to be leading to the concept of an “extraterritorial free-area” free from the usual Customs controls and resulting in reduced Customs’ involvement in monitoring cargo movements inside FZs as well as relaxed Customs procedures/controls therein, thus opening the way for higher risks of illegal trade.
- 1.5 Furthermore the concept of an “extraterritorial free-area” is also resulting in the use of FZs to avoid any counter measures to combat illegal trade or to free ride on preferential tariff treatment through false declarations or by disguising the origin of goods.
- 1.6 The various territorial definitions of FZs and their application in WCO Member countries can be roughly categorized into four types, as described in Table 1 below.

[Table 1]

<i>Pattern</i>	<i>Territorial definition of FZs</i>	<i>Application of Customs procedures/control</i>
1	FZs are regarded as inside the Customs territory	Customs procedures/control are applicable to FZs
2	FZs are regarded as outside the Customs territory only insofar as duties are concerned	Customs procedures/control are applicable to FZs
3	FZs are regarded as outside the Customs territory	Customs procedures/control are applicable to FZs, supported by clear provisions in related national laws.
4	FZs are regarded as outside the Customs territory	Usual Customs procedures/control do not apply to FZs

- 1.7 It should be noted that there are countries which recognize FZs as outside the Customs territory, though application of adequate Customs procedures/control in FZs is legally safeguarded by national laws (Pattern 3). However such patterns usually occur in those countries where Customs authority has relatively strong power inside the government to influence national legislation. There is a greater number of countries facing difficulties in ensuring the adequate application of Customs procedures/controls because the territorial definition of FZs is that they are “outside” the Customs territory.
- 1.8 To sum up, it is essential that FZs be regarded as geographically inside the Customs territory or as special areas where all non-tariff Customs activities, such as Customs procedures and border control functions (including inspections and seizures) are applied and properly enforced. FZs should be regarded as geographically outside the Customs territory only if national legislation ensures that all non-tariff Customs activities, such as Customs procedures and border control functions (including inspections and seizures) are applied and enforced properly.

National experiences

Example 1: European Union (EU)

- 1.9 The Union Customs Code (UCC) defines and treats FZs as inside the Customs territory. Article 243, Section 3 (Free zones) of the UCC states that “Member States may designate parts of the customs territory of the Union as free zones” and “Persons, goods and means of transport entering or leaving free zones may be subject to Customs control”.

Guidance for territoriality aspects of FZs:

- ✓ FZs should, from a geographical perspective, be regarded as a part of the Customs territory or of other special areas where Customs’ authority to control the goods and persons is legally safeguarded, and where the necessary Customs procedures and control are applied to secure and facilitate the movement and placement of cargoes in FZs.

2. Full involvement by Customs in FZs

Why is Customs less involved in FZs? How can full involvement be achieved?

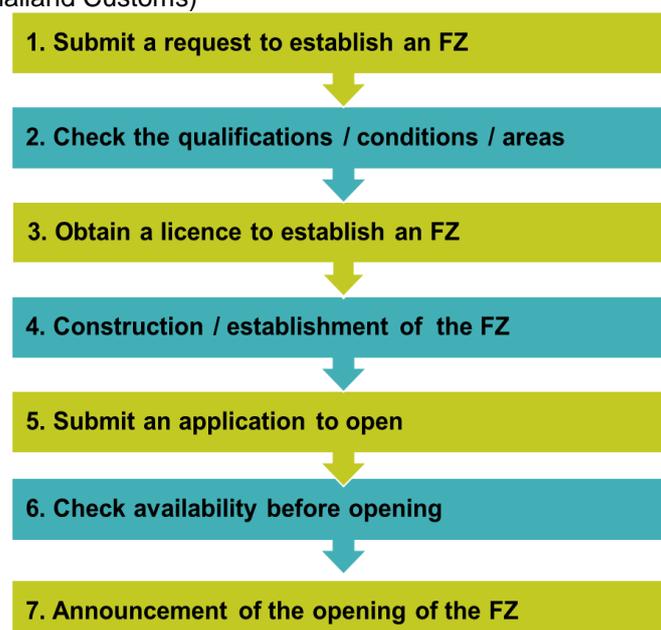
Explanation

- 2.1 Many existing academic papers, such as the FATF (2010), the ICC (2013), The Economist (2018), the OECD (2018) and McKinsey & Company (2019), have urgently called for a high level of Customs involvement and empowerment of Customs to control goods and activities inside FZs.
- 2.2 FZs are established and operated from an economic/industrial policy perspective. Typically, ministries governing economic development or the zone authorities answerable to such ministries play a leading role in establishing the FZ or approving the companies starting to operate therein, and Customs is usually less involved. According to the WCO online survey, almost 40% of Customs administrations are not

involved in establishing FZs. This result may suggest a lack of political will to secure Customs' involvement.

- 2.3 Customs has important powers that exist nowhere else in government, namely the authority to inspect cargo and goods shipped into, through and out of a country. Customs also has the authority to refuse entry or exit and the authority to expedite entry based on information about goods. Given its unique authority and expertise in both securing and facilitating global trade, Customs should be a crucial player in the general development of national policies related to FZs, the establishment of each new FZ and the approval of FZ tenants including admissible activities by FZ tenants.
- 2.4 As the example of the Dominican Republic indicates, some Customs administrations reported that Customs is represented as a main member on a governmental board to decide national policies related to FZs, the establishment of FZs and review applications for FZs. Another example shows that such governmental boards could authorize Customs to review and examine applications for and the establishment of FZs. It seems that being a formal member of a governmental board would provide greater opportunities to play a part in all decisions related to FZs and would also ensure smooth communication with the relevant bodies.
- 2.5 Furthermore, in response to the WCO online survey and during workshops, several Members stressed the importance of defining construction standards which enable the appropriate Customs procedures/controls to be carried out in FZs. As prescribed in Standard 3 of Chapter 2, Specific Annex D to the RKC, Customs shall lay down the arrangements for Customs control including appropriate requirements as regards the suitability, construction and layout of FZs. Well-designed layout/construction of FZs contributes to smooth legitimate cargo flows while properly monitoring cargo movement and companies' activities.
- 2.6 An example of an approval process is described as in Chart 1 below. Within this process, Customs should be involved in checking qualifications/conditions/areas, examining application to establish the FZ, approving goods to be admitted into the FZ together with admissible operations, approving the construction plan and examining implementation of each qualification and condition before any new FZs are opened.

[Chart 1] (Source: Thailand Customs)



National experiences

Example 1: China

- 2.7 China Customs is responsible for reviewing applications to establish FZs. Every provincial and municipal government may apply to the State Council in order to establish FZs based on actual development needs. It is within the administrative power of the State Council to give final approval to FZ applications and the latter also authorizes China Customs to review the application during the process.
- 2.8 When reviewing an application, China Customs asks the opinions from seven other ministries, including the Ministry of Natural Resources and the Ministry of Finance. China Customs has established an evaluation system for setting up FZ, which includes assessment criteria covering foreign trade and processing trade volumes, degree of support for Customs supervision, industrial support conditions, and logistical convenience, etc.
- 2.9 With respect to the construction of FZs, China Customs has developed basic construction standards covering the check-point, enclosed fencing surrounding the FZ, Customs inspection areas, and interfaces between computer systems and the Customs system, etc.

Example 2: Dominican Republic

- 2.10 In order to ensure smooth communication between Customs and FZ operating bodies as well as tenant companies located therein, an Agreement on Services was developed. Two committees were also set up to meet a monthly basis and discuss all matters related to the services and requirements of the parties involved:
- A National Committee, composed of the National Council of Free Trade Zones, Customs, and the Dominican Association of Free Trade Zone Companies; and
 - An Internal Committee, which must be established at each Free Zone Park, composed of a representative of the Free Zone Park operating company, a representative of the Dominican Association of Free Trade Zone Companies, and the Head of the Customs Office located in the Park.
- 2.11 In the Dominican Republic, the National Council of Free Trade Zones is responsible for issuing FZ licenses and regulating operations in FZs; however it is not responsible for Customs control arrangements, the responsibility for which rest with Customs.

Example 3: Singapore

- 2.12 Singapore Customs administers and enforces the Free Trade Zones Act (FTZ Act), which governs the establishment of an FZ, appointment of a FZ operating bodies or to manage FZs and the required responsibilities of a FZ operating body.
- 2.13 There are Customs examination stations at all entrances and exits of FZs. In addition, as part of the regulatory checks, Singapore Customs also performs the following duties in FZs:
- conducting checks on premises, examine packages and take action against any offence committed including violations of Customs law;
 - instructing FZ operating bodies to prevent unauthorized persons or goods from entering/leaving FZs;
 - ensuring that FZ Operating bodies are aware of their responsibilities under the FTZ

- Act and other legislation enforced by Singapore Customs; and
- approving the perimeter fencing around FZs.

Example 4: Republic of Azerbaijan

- 2.14 The Law of the Republic of Azerbaijan on “Alyat Free Economic Zone” was adopted on 18 May 2018. It is envisaged that Alyat Free Economic Zone (FEZ) will be established in the near future. Alyat FEZ will act as a major logistics hub in the Caspian region, serving both the European and Asian markets as well as being part of an extensive international logistics network linking Europe and Asia and acting as a multimodal transit logistics hub.
- 2.15 According to national legislation, Azerbaijan Customs has the following responsibilities regarding FZs:
- perimeters, entrance and exit points, and persons entering and exiting FZs should be under Customs surveillance;
 - activities related to goods brought into FZ, including their preservation, packaging, marking etc., are subject to Azerbaijan Customs’ permission; and
 - construction work in an FZ should be carried out with the approval of Azerbaijan Customs.
- 2.16 Azerbaijan Customs is involved in permission procedures for commercial and other activities in FZs.

Guidance for Customs involvement in FZs

- ✓ Customs should be represented on the relevant governmental board to develop the overall national policy on FZs, decide on the establishment of FZs and review applications to establish FZs.
- ✓ Customs should establish basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs check-points, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance system, installation of Non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

3. Company approval process

A Company approval process without Customs involvement may open up FZs to illegal activities

Explanation

i. Less involvement in company approval process

- 3.1 In response to the WCO online survey, some Customs administrations underlined the need for awareness-raising on the responsibilities and obligations of companies in FZs with respect to Customs procedures, as well as the importance of Customs’ full involvement in the company approval process. However, the same survey also revealed that almost half of Customs administrations are not involved in the process of company approval. Furthermore, in some countries, Customs has no authority to revoke companies’ rights to operate in FZs, particularly those accused of perpetrating

smuggling activities within FZs, even though this is the authority naturally endowed to Customs to secure the global trade.

- 3.2 As indicated by the WCO Research Paper No.47, the Financial Action Task Force (FATF) report (2010) outlined several cases whereby bank accounts belonging to tenant companies operating inside FZs were used for laundering the proceeds of drug trafficking, etc., with involvement by companies inside FZs. The FATF report identified several factors as enabling FZ-related money laundering, including cash transactions inside FZs, lack of integration between FZ operating bodies' and Customs' IT systems, and lack of due diligence and compliance record checks during the initial phase of admitting companies into FZs.
- 3.3 In order to provide the benefits including simplified Customs procedures, offered as one of the main characteristics of FZs, it is crucial that FZ operating bodies and tenant companies operating inside FZs demonstrate high compliance standards and a high degree of responsibility to ensure their activities are secure. They should also have no records of illegal activities, serious infringements or violations of laws.
- 3.4 Customs' failure to conduct risk-based background checks on FZ applicant companies, their key employees, and compliance records could become a significant enabling factor for illicit trade related to FZs. Given the fact that organized crime and even terrorism organizations are involved in illicit activities inside some FZs, Customs' involvement in due diligence and compliance record checks at the company approval stage is of critical importance.
- 3.5 Additionally, Customs should take appropriate actions to revoke permits if it observes any non-compliance, illegal activities or loss of goods.

ii. Applying the "Authorized Economic Operators (AEO)" concept

- 3.6 As a result of limited resources and staffing, Customs administrations are now facing various challenges in managing increasing volumes of cargoes and adapting to new types of business including the growing use of FZs, while adequately responding to the developing need to secure global trade. As a consequence, Customs' perspective of companies has changed from seeing them as entities paying duties or possibly involved in illegal activities, to seeing them as trusted partners working with Customs to achieve effective and efficient border procedures in a rapidly changing environment.
- 3.7 Consequently, one possible method of efficiently managing cargoes and companies inside FZs while providing benefits could be to apply AEO concept.
- 3.8 The AEO is a model programme that many Customs administrations are pursuing as a means to secure and facilitate global trade, while at the same time providing incentives that benefit both Customs and traders having decided to work in partnership. The WCO Framework of Standards to Secure and Facilitate Global Trade (SAFE) is a document that provides overall guidance for this purpose.
- 3.9 The SAFE provides a set of international Customs standards on conditions and requirements for AEO status, namely with respect to:
 - demonstrated compliance with Customs requirements;
 - satisfactory system for management of commercial records;
 - financial viability;
 - consultation, co-operation and communication;

- education, training and awareness;
 - information exchange, access and confidentiality;
 - cargo security, conveyance security, premises security, personnel security and trading partner security;
 - crisis management and incident recovery; and
 - measurement, analyses and improvement.
- 3.10 Together with a list of specific benefits for each category of economic operator, application, validation and authorization procedures are also provided by the SAFE in order to establish and maintain an effective AEO programme.
- 3.11 The WCO online survey shows that administrations which apply the AEO concept in FZs amount to less than half of the respondents. In one country which took part in a workshop, Customs has not granted AEO status to companies inside FZs because the Ministry of Commerce has jurisdiction in this area and Customs is less involvement in the company' approval process.
- 3.12 Benefits within FZs should be provided only to companies meeting the globally established criteria provided by the SAFE. Applying different sets of requirements could be a burden on the international trade community and could also result in lower levels of compliance. Given its abundant knowledge of and expertise in AEO implementation together with the relevant risk- and trade security-related intelligence, Customs should be the authority to conduct security risk assessment and AEO-related validation procedures to grant tangible benefits in FZs.
- 3.13 Thus, the power of Customs to grant AEO status and applicable benefit levels should not be delegated to a third party validator and misuse of the AEO concept by means of a different set of criteria and implementation method should be avoided.
- 3.14 Through Customs' active involvement in the company approval process and possible granting of AEO status, FZs can utilize Customs administrations' experience and intelligence to validate whether a company meets high standards of compliance and have no record of any offences so as to prevent possible illegal actives in FZs while ensuring the companies enjoy the benefits.

National experiences

Example 1: China

- 3.15 China Customs is involved in the process of approving companies if the latter's business is related to Customs matters. China Customs reviews whether or not the applicant companies have any record of smuggling.
- 3.16 Firstly, any company in an FZ needs to obtain a registered commercial licence from the Market Supervision Administration. After commercial registration, the company should register with Customs and obtain Customs approval before starting its business in an FZ.
- 3.17 The Customs registration process includes: (1) submission of an application for registration and recording; (2) Customs verification; and (3) Customs inspection on site.
- 3.18 Companies need to meet the following basic requirements to be registered with Customs:

- be an independent legal entity, with the ability to pay taxes to Customs and meet other legal obligations;
- be equipped with a computer management system comprising terminal equipment for data access by Customs and software-based interfaces with Customs computer systems, in accordance with Customs authentication and data networking standards;
- demonstrate adequate financial management and, in particular, accurate records of inventory, assignment, transfer, sale, processing and use of goods, and required bookkeeping and accounting; and
- do not produce commodities requiring high energy consumption, and which are highly polluting/resource dense, or process commodities listed in the "prohibition catalogue", in line with national industrial development requirements.

3.19 Customs categorizes companies into three groups for corporate credit conditions: (1) certified enterprise; (2) general credit enterprise; and (3) non-accredited enterprise, based on information collected and analysed by China Customs. Certificated enterprises are certified by China Customs as AEO.

Example 2: Singapore

3.20 The FZ operating body conducts screening of businesses and persons wishing to operate in an FZ with relevant agencies including Singapore Customs, before giving the applicant approval to operate in an FZ. FZ operating bodies regularly update Singapore Customs the list of companies operating in FZs.

3.21 Singapore Customs only permits limited activities in FZs. Should companies wish to carry out manufacturing activities within FZs, they need to seek permission from Singapore Customs. Additionally, if companies want to be involved in importing or exporting activities, including acting as declaring agents, they need to be registered with Singapore Customs.

3.22 Singapore's AEO Programme is applicable to all eligible companies along the supply chain, including port operators and companies that operate inside FZs.

Example 3: South Africa

3.23 In South Africa, Special Economic Zones (SEZs) are geographically designated areas set aside for specifically targeted economic activities to promote national economic growth and export by using support measures to attract foreign and domestic investments and technology.

3.24 An SEZ is sub-divided into a general zone open to all industries and a separate Customs Controlled Area (CCA) reserved for export-oriented, CCA-registered enterprises. A CCA is a designated area approved by the South African Revenue Service (SARS) and the Ministry of Industry and Trade located in an SEZ. The entrances to and exits from the CCA are controlled by an SEZ Operator who provides Customs with reports when requested by Customs.

3.25 A Customs Controlled Area Enterprise (CCAEE) is an approved business holding a SEZ permit, situated in a CCA and entitled to be a storage warehouse or manufacturer.

3.26 A decision was also taken to adopt a whole-of-SARS approach in dealing with SEZs by establishing a Working Group between SARS and SEZ Operators. This creates

synergy in SARS and strengthens relations with SEZ Operators. Although still in the initial stages, it has proven effective in enhancing communication and cooperation. The Preferred Trader Programme, the precursor to the AEO Programme, is promoted to all companies in the CCA.

Example 4: Republic of Serbia

3.27 The Government may designate parts of Customs territory of the Republic of Serbia as an FZ. FZs must be fenced and include points of entry. Persons, goods and means of transports may enter or leave the free zone only through points of entry and exit and may be subject to Customs control.

3.28 The construction of any building in an FZ requires Customs authority's approval. Economic activities in FZs shall be carried out under the conditions prescribed by the national law and Customs authority must be informed in advance of the pursuit of economic activities in FZs. Customs authority may prohibit the pursuit of the activities in FZs if companies do not provide the necessary proof of compliance with the Customs regulations.

Example 5: Thailand

3.29 The Specification and Tax Incentives Registration Section of the Tax Incentives Division of Thailand Customs Department approves requests for permission to operate a business in an FZ in accordance with the rules, procedures and conditions specified in the Ministerial Regulation. When granted permission, an operation in the FZ may proceed.

Guidance for Customs' approval of FZ operators and companies operating in FZs

- ✓ Customs should be involved and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- ✓ Customs should be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.
- ✓ Customs should develop certain criteria to verify compliance levels as well as records of any infringements, as well as possible system interfaces with Customs systems. AEO validation criteria may be apply mutatis mutandis.
- ✓ Customs should provide periodic training to companies on responsibility and compliance in FZs and provide opportunities to exchange and share the necessary information.
- ✓ In addition, Customs should take any appropriate actions to revoke approval if non-compliance is observed or illegal activities or losses of goods.

4. Limitation of Customs' authority inside FZs

In some countries, Customs officers cannot even enter FZs

Explanation

4.1 As exemption of Customs and other duties is one of the main characteristics of FZs, Customs' authority could be limited insofar as duties are concerned. On the other

hand, there is no doubt that Customs should be empowered to carry out Customs surveillance on goods and companies in FZs to the same degree as in other areas, in order to combat illicit trade in FZs, as many existing academic papers and literature have stressed.

4.2 However, discussions during WCO workshops and observations during the course of field studies revealed the actual situation in terms of limited Customs' authority inside FZs. As the WCO Research Paper No.47 highlights, in several countries Customs officers cannot even enter FZs without obtaining prior approval from an FZ operating body. Furthermore, in several countries, Customs officers cannot even enter FZs without concrete suspicion of illicit trade.

4.3 In addition, relaxed Customs procedures/controls inside FZs are possible enabling factors for illicit activities therein. The WCO Research Paper No.47 summarizes some examples of weak Customs procedures/controls in FZs as follows:

- No or fewer reporting requirements imposed on cargo entries coming from abroad to FZs or on cargo exiting FZs and going abroad: in several countries, as the entry of cargo from abroad to FZs does not yet constitute importation;
- Customs has no authority to request periodic reports from companies in FZs;
- Customs has no authority to audit companies inside FZs;
- Customs has authority to inspect cargo only at entry to and exit from FZs: Customs has no authority to inspect cargo movements inside FZs or to monitor companies' activities inside FZs.

4.4 Guidance for above-mentioned challenges is discussed and provided in Section 5 below.

5. Customs procedures

i. Declaration and reporting requirement

Declaration and reporting requirements are fundamental to ensuring the proper movement of cargoes

Explanation

5.1 Declaration and reporting requirements are the fundamental Customs scheme for ensuring the proper movement of cargoes coming from and going to foreign countries. Instead of conducting 100% physical inspections of goods, Customs have developed a risk management system based on the data submitted via declarations and reporting. Accordingly, declarations and reporting requirements are essential for ensuring that cargoes in the FZs are compliant with national and international legal requirements for fair, safe and secure international trade as well as possible facilitation.

5.2 Cargo movements in FZs can be categorized into three stages:

- 1) Entry to FZs;
- 2) Storage and processing at company site inside FZs; and
- 3) Exit from FZs.

Goods declaration for entry to and exit from FZs

- 5.3 Regarding entry to and exit from FZs, goods declarations or other documents for such cargo movements should be required and submitted to Customs, so that Customs can judge whether the goods are admissible to FZs and verify full compliance with all applicable laws and regulations.
- 5.4 Considering the characteristic of FZs whereby duties and taxes are not normally imposed, such goods declarations for FZs could exclude data elements related solely to calculation of duties and taxes but would need to include data elements necessary for conducting risk assessment. On the other hand, as simplified Customs procedures may be one of the benefits of FZs, simplified goods declarations could be permitted for companies demonstrating high level of compliance, such as those certified as AEOs.
- 5.5 Furthermore, such declarations may generate necessary statistics on FZs which would be important to grasp the trade including those for free zones. As recommended by the United Nations' 'International Merchandise Trade Statistics: Concepts and Definitions 2010', goods imported into and exported from FZs should be covered by trade statistics.
- 5.6 However, mainly in countries where the entry of cargo from abroad to FZs does not constitute importation, the goods declaration for such cargo movements is not even required, as explained in WCO Research Paper No.47. During a WCO workshop in 2019, one country reported that the utilization of data to control the movement of cargo for entry/exit, transit/transshipment, import and export is under the jurisdiction of the Free Zone authority and not Customs.

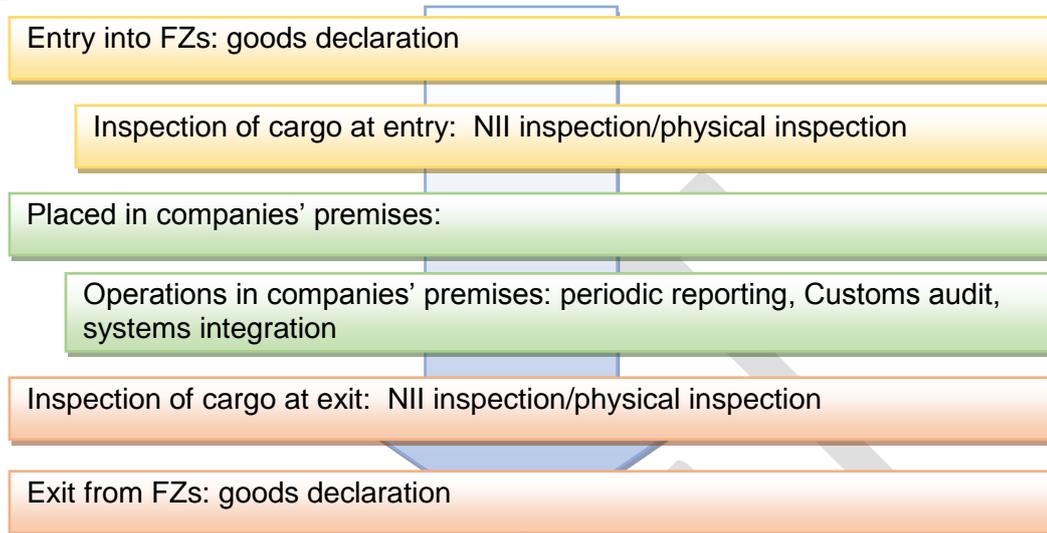
Reporting/filing requirement for goods placed in FZs

- 5.7 In addition, as the main use of FZs are processing, manufacturing and storing goods with longer or unlimited storage periods, it is essential to ensure that Customs captures and controls not only movements of cargoes at entry and exit points, but also during the storage and processing stages.
- 5.8 One possible way of controlling the movement and status of goods placed in FZs is to require periodical reporting as is necessary in Customs warehouses or during inward processing procedures. Another way would be to connect an FZ's inventory and book-keeping system to the Customs system so that the Customs side can access the system and obtain the data periodically and whenever necessary. Sometimes, FZ operating bodies are responsible for keeping such records and sharing them with Customs.
- 5.9 However, during the WCO workshops some countries explained that such reporting is expected to be submitted to FZ Authorities or FZ operating bodies and not to Customs, and that the systems for storing information on goods placed in FZs are not connected to Customs.
- 5.10 The exemption from submission of a goods declaration and from reporting requirements on the movement or status of cargoes in FZs can be regarded as one of main characteristics for facilitation in FZs. On the other hand, relaxed requirements on goods declarations and reporting open the door to potential illegal activities in FZs. As reported in the WCO Research Paper No.47, illicit drugs bound for consignees inside FZs were detected at entry to some FZs as a result of information in declarations and

following Customs inspections. It is therefore essential for Customs to receive and analyse goods declarations at entry and exit, along with reports on cargoes stored and placed in FZs.

5.11 The ideal declaration and reporting procedures are set out in Chart 2 below:

[Chart 2]



National experience

Example 1: Jordan

5.12 The Customs procedures in FZs are as follows:

- goods arrive at the port of entry to the country (seaport, airport, land border);
- goods are transported to the FZ under the Customs transit regime;
- upon reaching the FZ for deposit, the following procedures are carried out:
 - a. physical inspection for deposit purposes: the inspection is conducted by Customs for deposit purposes while the deposit is conducted by the FZ administration;
 - b. the goods are deposited in the warehouses, factories (if raw materials) showrooms, etc. inside the FZ;
 - c. the goods may be withdrawn from the FZ in various forms (in their original form, manufactured, dismantled, etc.);
 - d. for withdrawal purposes, there should be a withdrawal document from the FZs which becomes the basis for the exit Customs declaration;
 - e. The Customs declaration can be prepared under several regimes (free circulation if the goods are intended for the local market, and transit if the goods are intended for other countries or other FZs).

Example 2: Singapore

5.13 As with all businesses registered in Singapore, companies operating in FZs are required to maintain documents, including sales, accounting, bank, inventory and other relevant records of all transactions, for a minimum of five (5) years. Singapore Customs and other law enforcement agencies in Singapore can demand these records

for the purpose of enforcement or investigation. Singapore Customs also has direct access to cargo data stored in FZ operating bodies' systems.

- 5.14 It is also a requirement for businesses, including companies operating in FZs to file a suspicious transaction report if they know or have reasonable grounds to suspect that property may be linked to a criminal conduct.

Guidance for submission of declarations and reporting

- ✓ Goods declarations or other form of declarations at entry to and exit from FZs should be requested and submitted to Customs in order to conduct risk assessment of cargoes.
- ✓ Goods declarations could exclude elements related solely to duty declarations but should include the elements necessary for risk assessment.
- ✓ Simplified declarations should be permitted for companies which demonstrate a high level of compliance, such as those certified as AEOs.
- ✓ Companies operating in FZs are required to keep inventory books and other records on operations and processing conducted in FZs. Companies operating in FZs or FZ operating bodies should report periodically to Customs.
- ✓ If required by Customs, FZ companies or FZ operating bodies need to submit the necessary reports, including the balance of cargoes, raw materials and a list of inventories, etc. to the Customs authority, upon request.

ii. Use of IT system and data in FZs

Insufficient IT integration/utilization could hinder facilitation and security of FZs

Explanation

- 5.15 Customs has developed risk management systems based on the data submitted via declaration and reporting, and a fundamental assumption that data and reporting are submitted via an IT system in order to conduct risk assessments based on data analysis.
- 5.16 During the course of the WCO workshops and field studies, the emphasis was placed by both Customs and traders on the need to process, and keep records of, declarations and to submit trade related documents in electronic formats. However, there are FZs where such declarations and reporting are conducted on a paper basis rather than through an IT system.
- 5.17 FZs are normally governed by FZ Authorities and FZ operating bodies other than Customs. FZ operating bodies develop their own system for storing data on cargo movements and company operations inside their FZs by connecting their IT system to the company's IT system. On occasion FZ operating bodies may authorize a tenant company to keep its own inventory control and record-keeping system.
- 5.18 In such cases, Customs sometimes has limited access to the FZ operating body's cargo management system. A shortage of electronic data on cargo movements, inventories and company operations inside FZs will hinder Customs' risk management,

which is reliant on data. Thus, it would be desirable for Customs to have full access to such data stored electronically in the FZ operating body's system.

- 5.19 From the perspectives of FZ operating bodies, simplifying and expediting Customs procedures by digitalization may be one of the key advantages for FZs in attracting clients. Providing customs access to the FZ operating body's IT system and obtaining data provided by tenant companies could play a significant role by allowing adequate Customs control, including entry/exit and inventory controls while expediting Customs procedures.

National experience

Example 1: China

- 5.20 Customs controls on enterprises and business are conducted by China Customs through the IT system. Companies in FZs must run their computer systems in accordance with standards set by Customs for adequate Customs control, and provide Customs with terminal equipment for data access and a software interface for computer applications, to be connected with Customs in accordance to the authentication method and data standards prescribed by Customs. Customs monitors enterprises through their account books, checks and audits. It also carries out classified credit management on companies both inside and outside FZs.

Example 2: Thailand

- 5.21 FZ operators are required to submit an importation and exportation report, balance report, cargo movement report, and scrap and losses report, according to the form prescribed by the Customs Department in electronic format, to the Duty Free Zone Audit Section, the Tax Incentives Division within 30 days from the end of the specified period. This report should be submitted twice a year along with the annual financial statements certified by the Customs auditor.

Example 3: Jordan

- 5.22 Zarqa Free Zone is located near the border with Iraq, Syria, and Saudi Arabia. it is controlled strictly through the following measures:
- companies need to produce three account books for product, materials, and waste which need to be submitted to two authorities (FZ Authority under the Ministry of Finance and the Customs administration);
 - the IT system is connected between Customs (under the Ministry of Finance) and the FZ Authority (under the Ministry of Finance), so that Customs can see all the information which companies submit to the FZ operating body;
 - companies submit declaration information (via brokers) to Customs using the ASYCUDA system. The IT connection between Customs and the FZ Authority was created based on ASYCUDA.

Example 4: Georgia

- 5.23 The Customs Service is present 24/7 in the Zones, and has the right to perform scheduled or random checks of the premises and inventory of companies located therein. Goods entering the Zones must belong to a registered company. Imports and exports as well as transit operations between the Zones are managed through the Customs automated system as well as through the Tax Administration Information System. Specific risk indicators designed to target risks most common to Free Industrial Zones have been input into the Customs risk engine.

- 5.24 Incoming and outgoing transport operations and Customs clearances processes are processed according to the “one-stop shop” principle, and services such as the electronic submission of Customs documents, remote acceptance of electronic signatures, and the payment of duties, taxes and service fees via online banking services are provided to importers or exporters. As a result, importers and exporters do not need to be physically present during the Customs clearance process or other Customs procedures.

Guidance for IT systems and data in FZs

- ✓ The person concerned should lodge a goods declaration in respect of goods introduced into or exiting from an FZ by using electronic data-processing techniques.
- ✓ The FZ operating body’s system and/or company’s system storing the data on cargo movements, inventories and company operations inside FZs should be connected to Customs system. Failing that, Customs should have full access to such a system whenever necessary for the purpose of Customs procedures and control.
- ✓ By utilizing the data submitted or obtained through IT systems, Customs should facilitate Customs procedures and control to the greatest extent possible.

iii. Customs Audit in FZs

Customs audit is necessary to control companies’ activities and cargoes stored in FZs over an unlimited period

Explanation

- 5.27 According to the WCO online survey, most Customs administrations have the authority to conduct a Customs audit on goods in FZs, as well as an audit of the inventory books and other records on operations and processing conducted in FZs.
- 5.28 Considering the unlimited period for manufacturing and storing goods in FZs, a Customs audit of companies operating in FZs is one of the most suitable and main tools for Customs to supervise activities in FZs. A Customs audit allows Customs to effectively and efficiently control not only the movements of cargoes at entry and exit points on a transaction basis, but also during the storage and processing stages for a certain period of time on a contract or periodic basis.
- 5.29 Such a Customs audit may be exercised through, but is not limited to audits of records, quantity counts of goods in an inventory, compliance reviews of selected transactions or procedures, and reviews of record-keeping, security or storage conditions.
- 5.30 It should be stressed that the FZ operating body’s cooperation and assistance is necessary to ensure an effective and efficient Customs audit, and such assistance includes permission to access FZs’ and companies’ premises/factories, an explanation of operations and the record-keeping system, and the necessary access to computer systems which store relevant data.

National experience

Example 1: Dominican Republic

- 5.31 The General Directorate of Customs has established a Free Trade Zones Deputy Directorate, whose main role is to supervise, control and authorize all imports, exports, transfers of goods, and other regimes that companies operating in an FZ may use.
- 5.32 The Free Trade Zones Deputy Directorate, along with the Customs Intelligence, Audit and Post Clearance Audit Departments, rigorously and continuously analyses, controls and supervises all operations that FZ-based companies must execute, in order to avoid potential illicit acts or the misuse of benefits and exemptions granted to FZ participants. Similarly, the Ministry of Finance monitors financial transactions, with the support of the General Directorate of Internal Revenue.

Example 2: South Africa

- 5.33 Companies in FZs may join the Preferred Trader Programme (PTP) and the SARS's Relationship Managers assist companies to meet compliance standards. To be part of the PTP, companies need to undergo a rigorous audit by SARS prior to accreditation as a compliant preferred trader.

Example 3: Thailand

- 5.34 Thailand Customs conduct Customs audit in FZs in case of having reasonable doubts on violation of Customs regulations by the Post Clearance Audit Division. Thailand Customs also conduct periodical Customs audit by the Duty Free Audit Section by auditing accounts and all documents related to importations and exportations in FZs.
- 5.35 For periodical audit in FZs, Thailand Customs applies risk management concept by categorized companies into three levels:
- Platinum level - audit every three year (including AEO companies);
 - Gold level - audit every two year;
 - Silver level - audit every year.

Guidance for Customs audit in FZs

- ✓ The Customs administration should adopt and conduct Customs audits for companies operating in FZs to examine and control not only movements of cargoes at entry and exit points, but also during the cargo storage and processing stages.
- ✓ The Customs administration should select a company or consignment for a Customs audit in a risk-based manner, which may include appropriate selectivity criteria.
- ✓ The FZ operating body should permit Customs access to the FZ and provide assistance to the Customs administration when conducting a Customs audit, including access to available computer systems, and an explanation of operations and record-keeping systems.

6. Customs control/surveillance

Explanation

- 6.1 WCO Research Paper No.47 points out that there are inherent risks associated with the establishment of FZs, and although these might have escaped the attention of policymakers, they are now making headlines internationally as civil society, international and commercial organizations have repeatedly claimed that FZs are not only utilized by legitimate economic actors for legal economic activities but are also occasionally misused for illicit activities.
- 6.2 Between January 2011 and August 2018, some 48 WCO Members reported over 600 seizures in relation to FZs (over 1,300 when including an outlier), ranging from duty fraud, drugs, intellectual property right (IPR) infringements, origin fraud, drugs, arms, money laundering and cultural heritage smuggling.
- 6.3 Similarly, the results of the WCO online survey reveal various types of detection and seizure in FZs and Members also reported certain cases which may be related to terrorist activities, such as the detection and seizure of small arms and light weapons, explosives and cultural heritage goods, as well as money laundering.
- 6.4 FZ operating bodies should be responsible for maintaining the FZs and establishing adequate procedures for ensuring the security of cargoes located therein, in accordance with applicable national security standards. Customs should play a role in monitoring FZ operating bodies' and tenant companies' maintenance of security standards and requirements, and conduct the necessary Customs surveillance including inspection, detection and seizure of illegal goods in FZs, as described in below.

i. Authority on detecting/seizing illegal goods in FZs

“Extraterritoriality” of FZs leads to difficulties in applying general regulations on illicit trade to FZs

Explanation

- 6.5 It should be noted that according to the WCO FZ survey, several Members do not have the authority to detect/seize illegal goods in FZs. In addition, WCO Research Paper No.47 describes several cases, reported during the WCO workshops, in which FZs were exploited to disguise the origin of goods and to dispatch prohibited or illegal goods to other countries, rather than for domestic consumption.
- 6.6 Therefore, Customs should also be granted competence to detect and seize goods intended for transit and transshipment.
- 6.7 Furthermore, as WCO Research Paper No.47 clearly points out, in general, FZs have not been explicitly covered by existing international conventions which substantively regulate illicit trade. This tendency leads to the lower ruling of illicit trade both at global and national level and it is worth stating that the concept of “extraterritoriality” of FZs may also lead to difficulties in applying general regulations on illicit trade to FZs.
- 6.8 In order to combat illegal activities in the FZs, firstly, any kind of illicit trade in goods should be prohibited by related international conventions and/or national regulations on the same basis as goods outside FZs. Secondly, Customs should have the competence to inspect goods in FZs as well as to detect and seize goods regardless

of whether the intended transactions are storage, manufacturing, transit/transshipment or domestic consumption.

National experience

Example 1: Singapore

6.9 Local authorities, including Singapore Customs have the legal power to enter into FZs and conduct checks on goods in FZs. If goods are found to have breached domestic laws, international conventions or treaties, the local authorities can seize the goods.

Example 2: Malaysia

6.10 In Malaysia, the power to seize goods intended for transit and transshipment is provided under the Customs Act 1967 and Free Zone Act 1990.

Example 3: Turkey

6.11 In Turkey, the Customs administration has the authority to detect or seize all types of goods defined under anti-smuggling legislation. Customs has the authority to detect or seize any illicitly traded goods intended for transit or transshipment.

Example 4: Jordan

6.12 The following goods shall not enter the FZs according to the Customs Law:

- Goods prohibited to public order infringements, such as weapons and drugs, determined by the competent authorities.
- Strong-smelling or inflammable goods other than fuels required for investment activities, which are permitted by the investing body and under its conditions.
- Drugs and psychotropic substances of all kinds and their derivatives.
- Goods originating in a country against which there is an economic boycott.
- Goods protected under intellectual property law (trademarks and copyrights).

Guidance for authorities on detecting/seizing illegal goods in FZs

- ✓ National legislation should clearly specify that articles whose importation is prohibited by any national laws should not enter FZs.
- ✓ Such articles should include, but not be limited to, narcotic drugs, IPR infringing goods linked to duty fraud, goods linked to origin fraud, light arms and small weapons, explosives, goods linked to money laundering, and smuggled cultural heritage.
- ✓ Customs should establish and maintain a system to detect consignments suspected of containing such illegal goods, regardless of whether the goods are intended for domestic consumptions, transit/transshipment or other purposes.

ii. **Authority to enter FZs to conduct on-site checks and inspections**

Some Customs administrations have very limited authority to conduct examinations and investigations inside FZs

Explanation

- 6.13 It is worth reiterating that since the main use of FZs is manufacturing and storing goods with longer than usual or unlimited storage periods, it is essential that Customs controls not only movements of cargoes at entry and exit points, but also during the storage and processing stages.
- 6.14 However, some Customs administrations have very limited authority to conduct examinations and investigations inside FZs; those Customs administrations are allowed to enter FZs and companies premises only if there is suspicion of illicit activity therein, backed up by concrete evidence. In such cases, the burden of proof for such suspicion is on the Customs side. This also applies in cases where the declarations and data are submitted to the FZ Authority and/or operating body, and not to Customs, making it much more difficult for Customs to enter FZs to inspect cargo.
- 6.15 As can be seen in several cases explained in WCO Research Paper No.47, cases of 'missing cargo' inside FZs are frequently observed. Therefore, on-site visits by Customs together with audit procedures and periodic reporting are essential to prevent and detect the illegal activities conducted inside FZs, and in particular on company premises. In fact, one country explained that an on-site visit and comparison between the account book and physical inventory resulted in the detection of missing inventory for which tax exemption inside the FZ had been exploited.

National experience

Example 1: Singapore

- 6.16 Customs works with FZ operators to conduct joint inspections.

Example 2: Jordan

- 6.17 In Jordan, an on-site visit and comparison between the account book and physical inventory resulted in the detection of missing inventory for which tax exemption inside the FZ had been exploited.

Example 3: Thailand

- 6.18 In Thailand, Customs offices/houses are located in FZs. Customs officers conduct inspections of cargoes in FZs according to a risk management scheme at the last port of destination where tax incentives are applied, as well as at the first port.
- 6.19 Customs also conducts on-site checks and inspection. Customs conducts Customs audit on-site periodically and also in case where there is a reasonable doubt that the provisions of the Customs Act or other laws related to Customs are violated. A Customs technical officer has the power to enter into premises of companies whose business are related to importations and exportation in FZs.

Guidance for on-site checks and inspections by Customs

- ✓ All persons carrying out an activity involving the storage, working, processing, or sale or purchase of goods in FZs should keep appropriate records in a form approved by the Customs.
- ✓ Customs should monitor the movement of goods and persons in FZs and inspect incoming, placed and outgoing cargoes and baggage based on risk management techniques.
- ✓ Customs should have the authority to conduct on-site check and inspections on companies' premises both periodically and at any time when considered necessary by Customs.

iii. Use of technologies for inspections in FZs

Explanation

- 6.20 Given Customs limited human resources and the increase in FZs around the globe, it is not an easy task to conduct surveillance over in all area if FZs. However, FZs are unique areas where new procedures and incentives have been applied experimentally. The challenge presented by FZs therefore also offers opportunities for Customs to take advantage of the special environment within FZs and apply, on an experimental basis, innovative Customs procedures/control by utilizing data and modern technologies.
- 6.21 The installation of a fence, wall or barbed wire fences is a basic requisite for FZs. Non-intrusive inspection (NII) equipment should be put in place together with well-planned flows of trucks and cargoes to facilitate and secure the movement of cargoes at the construction stage. Many FZs are equipped with a camera surveillance system which should cover all parts of the FZ and be linked to the Customs office therein.
- 6.22 The use of electronic locks on doors to companies' premises, and the use of electronic tracking systems for the transportation of cargoes between a port and an FZ also appear to be effective.
- 6.23 In any event, full use can be made of such technologies and equipment by linking the data or records to the existing Customs office inside or near the FZ.

National experience

Example 1: Jordan

- 6.24 In Jordan, the following development and modernization work has been done to facilitate and secure cargoes in FZs:
- application of an electronic payment system to pay Customs duties;
 - an electronic archiving system for most transactions;
 - installation of wireless computer networks to implement an electronic sampling system;
 - electronic link mechanism between the Customs Department system and the systems of private and public FZs;
 - camera surveillance systems covering all FZ areas;
 - electronic gates for the empty exit door;

- application of an electronic lock system to doors of companies' premises; and
- use of GPS, especially for selected transit cargoes: if selected as GPS-traced cargo, the IT system can monitor the cargo from headquarters and it is escorted by Customs officers.

Guidance for inspection technologies

- ✓ Customs should establish and maintain surveillance systems at FZ entry and exit control points as well as inside FZs. For this purpose, Customs should use non-intrusive inspection (NII) equipment, surveillance cameras and other technologies to monitor cargoes and people.
- ✓ NII equipment should be installed according to a well-planned flow line of lorries and cargoes developed by Customs and other authorities at the construction stage.
- ✓ Customs should explore the possibility of utilizing advanced technologies, such as electronic tracking systems and e-seals, to monitor cargo movements inside and outside FZs.

7. Cooperation

i. Cooperation with the private sector and other governmental agencies

Working together to solve any issues and challenges in FZs

Explanation

- 7.1 Enhancing cooperation with operators and companies in FZs is key to enhancing facilitation and safety/security within them. It is essential for Customs administrations to participate not only to control goods but also to facilitate trade, recognizing the significant role that Customs can play in the healthy and sustainable economic growth of FZs.
- 7.2 To that end, embedded cooperation mechanisms with operators and companies, such as periodic dialogue and reporting and the provision of adequate training, are necessary alongside the company approval process. Such periodic dialogue and sharing of information would enable Customs and the private sector to work together to solve any issues and challenges in FZs. The assignment of a Customs officer responsible for each company and zone might be another possible mechanism for sustainable cooperation.

National experience

Example 1: Georgia

- 7.3 As one of the key players in FZs, Customs is fully aware that not much can be done without building a strong partnership with FZ stakeholders. Therefore, industry outreach is one of the key components of its work, the objective being to enable Customs and business entities to share information and work together towards solving any problems and challenges.
- 7.4 Whenever companies registered in FZ wish to make a transaction, but are unsure of the regulation applying to the operation or need further information, they know that

they can approach Customs for guidance. Within its scope of competence, Customs is able to provide solutions and guide companies on how they should proceed. This is considered to be a Customs' "preventive analysis" approach, where problems are solved before they occur. Such an approach has become an integral part of the Customs and business working environment.

- 7.5 By developing a professional relationship with companies operating in FZs as well as with the administrators, Customs has been able to prevent infringements of the law and increase compliance. In practice, this endeavour made it possible to develop smooth and effective workflows within FZs and has reduced the number of irregularities and infringements.

Example 2: Dominican Republic

- 7.6 The General Directorate of Customs has established a Free Trade Zones Deputy Directorate, whose main role is to supervise, control and authorize all imports, exports and transfers of goods, and other regimes that companies operating in an FZ may use. Each procedure is implemented in accordance with high-quality standards, which promote the efficiency, integrity and transparency of all Customs processes. Customs' assistance contributes to time-saving with respect to imports and exports, which impacts positively on the competitiveness of participating companies.
- 7.7 The Free Trade Zones Deputy Directorate, along with the Customs Intelligence, Audit and Post Clearance Audit Departments, rigorously and continuously analyses, controls and supervises all operations that Free Zone-based companies must execute, in order to avoid potential illicit acts or the misuse of benefits and exemptions granted to FZ participants. Similarly, the Ministry of Finance monitors financial transactions, with the support of the General Directorate of Internal Revenue.

Example 3: Singapore

- 7.8 Singapore Customs has regular meetings with FZ operating bodies and established a contact points with FZ operating bodies. If FZ operating bodies have any suspicion of or detect any illicit activities in FZs, they will to report to Customs in a timely manner for effective enforcement.
- 7.9 FZ operating bodies also provide a monthly report to Singapore Customs. The report contains information relating to a list of business entities operating in FZs as well as any security incidents that have occurred in FZs.
- 7.10 Singapore Customs also works with FZ operating bodies to conduct joint inspections, incident and contingency drills and exercises. Singapore Customs also has access and system linkages to FZ operating body's systems. Singapore Customs performs regular outreach with FZ operating bodies and companies operating in FZs to remind them of the requirements to be met as well as to brief them on the latest detected cases of illicit activities in FZs.

Guidance for cooperation with the private sector and other governmental agencies

- ✓ Customs should establish and maintain cooperation mechanism with operators and companies, including measures such as periodic dialogue, reporting/information sharing, and the provision of adequate training.
- ✓ Through such periodic dialogue and information sharing, Customs, the private sector and other governmental agencies should work together to solve any issues and challenges in FZs.

ii. Cooperation among Customs

Explanation

- 7.11 As FZs originally focused on manufacturing for export, and as they are often used for transit purposes, any illegal activities also involve smuggling to other countries. Thus, proper Customs procedures/control in FZs are a crucial issue not only for countries with FZs, but also for those without them; possible solutions require international action and cooperation to combat illegal activities exploiting weaknesses in FZs.
- 7.12 Indeed, WCO Research Paper No.47 presents several cases where three or more countries were involved in the chain of transit/transshipment operations for illegal activities by utilizing FZs. This underscores the complexity and global nature of this issue and the necessity for intelligence sharing and international cooperation among Customs administrations.
- 7.13 During the WCO workshops on FZs, several countries highlighted the effectiveness of international information exchange among Customs along transit routes, which can be done by making use of international agreements such as Customs Mutual Assistance Agreements (CMAA). It is therefore important for these agreements to cover information exchange related to FZs by having an appropriate definition of FZs, without turning to the concept of FZs' "extraterritoriality" from the Customs territory.
- 7.14 One country also mentioned that global operations led by international organizations has resulted in the seizure of goods to evade duties, proving the effectiveness of global cooperation focused on illegal activities in FZs.
- 7.15 Furthermore, several cases of origin fraud were reported during the workshops. One involved cargoes placed in an FZ whose transport documents were falsified in an attempt to hide the origin country and to mis-declare the cargoes in the destination country. Additionally repacking and other light operations in an FZ may be exploited to change or remove the origin mark or to obtain a certificate of origin from the country where the FZ is located. To track these cargoes and ensure that the origin is accurate, cooperation among Customs and other governmental agencies en route is vital, together with the on-site checks and inspections to be conducted by the Customs administration in each FZ.

National experience

Example 1: Singapore

7.16 Singapore Customs receives and shares intelligence with its network of partners. This network includes both local and foreign law enforcement authorities, relevant international organizations such as the WCO, and foreign Customs administrations. Singapore Customs collaborates with local law enforcement agencies and other Customs administrations to conduct joint enforcement operations.

Example 2: Vietnam

7.17 Vietnam Customs exchanges information with other Customs administrations through mutual agreements between the two countries. If there is a suspicion of illicit trade, Customs in one country immediately informs Customs in other, providing all related information so that together they can track the routes taken by the goods and seize any illegal goods.

Guidance for cooperation among Customs

- ✓ Customs should cooperate with each other by sharing information based on Customs Mutual Assistant Agreements (CMAA) for the purpose of combating illegal activities utilizing FZs.
- ✓ Customs should establish a contact point to facilitate such cooperation among Customs.
- ✓ Appropriate controls should be exercised on documentation as well as on the goods themselves, so as to identify and check the true origin of goods in FZs through cooperation with other governmental agencies and also through cooperation with Customs, by tracking the routes taken by cargoes.

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ANNEX I

Definitions

(TO BE ADDED IN THE FINAL DRAFT)

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ANNEX II

Acronyms

(TO BE ADDED IN THE FINAL DRAFT)

DRAFT

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ANNEX III

Checklist

Territoriality aspects of FZs

- ✓ FZs should, from a geographical perspective, be regarded as a part of the Customs territory or of other special areas where Customs' authority to control the goods and person is legally safeguarded, and where the necessary Customs procedures and control are applied to secure and facilitate the movement and placement of cargoes in FZs.

Customs involvement in FZs

- ✓ Customs should be represented on the relevant governmental board to develop the overall national policy on FZs, decide on the establishment of FZs and review applications to establish FZs.
- ✓ Customs should establish basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs check-points, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance system, installation of Non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

Customs' approval of FZ operators and companies operating in FZs

- ✓ Customs should be involved and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- ✓ Customs should be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.
- ✓ Customs should develop certain criteria to verify compliance levels as well as records of any infringements, as well as possible system interfaces with Customs systems. AEO validation criteria may be apply mutatis mutandis.
- ✓ Customs should provide periodic training to companies on responsibility and compliance in FZs and provide opportunities to exchange and share the necessary information.
- ✓ In addition, Customs should take any appropriate actions to revoke approval if non-compliance is observed or illegal activities or losses of goods.

Declarations and reporting

- ✓ Goods declarations or other form of declarations at entry to and exit from FZs should be requested and submitted to Customs in order to conduct risk assessment of cargoes.
- ✓ Goods declarations could exclude elements related solely to duty declarations but should include the item elements necessary for risk management.
- ✓ Simplified declarations should be permitted for companies which demonstrate a high level of compliance, such as those certified as AEOs.

- ✓ Companies operating in FZs are required to keep inventory books and other records on operations and processing conducted in FZs. Companies operating in FZs or FZ operating bodies should report periodically to Customs.
- ✓ If required by Customs, FZ companies or FZ operating bodies need to submit the necessary reports, including the balance of cargoes, raw materials and a list of inventories, etc. to the Customs authority, upon request.

IT systems and data in FZs

- ✓ The person concerned should lodge a goods declaration in respect of goods introduced into or exiting from an FZ by using electronic data-processing techniques.
- ✓ The FZ operating body's system and/or company's system storing the data on cargo movements, inventories and company operations inside FZs should be connected to Customs system. Failing that, Customs should have full access to such a system whenever necessary for the purpose of Customs procedures and control.
- ✓ By utilizing the data submitted or obtained through IT systems, Customs should facilitate Customs procedures and control to the greatest extent possible.

Customs audit in FZs

- ✓ The Customs administration should adopt and conduct Customs audits for companies operating in FZs to examine and control not only movements of cargoes at entry and exit points, but also during the cargo storage and processing stages.
- ✓ The Customs administration should select a company or consignment for a Customs audit in a risk-based manner, which may include appropriate selectivity criteria.
- ✓ The FZ operating body should permit Customs access to the FZ and provide assistance to the Customs administration when conducting a Customs audit, including access to available computer systems, and an explanation of operations and record-keeping systems.

Authorities on detecting/seizing illegal goods in FZs

- ✓ National legislation should clearly specify that articles whose importation is prohibited by any national laws should not enter FZs.
- ✓ Such articles should include, but not be limited to, narcotic drugs, IPR infringing goods linked to duty fraud, goods linked to origin fraud, light arms and small weapons, explosives, goods linked to money laundering, and smuggled cultural heritage.
- ✓ Customs should establish and maintain a system to detect consignments suspected of containing such illegal goods, regardless of whether the goods are intended for domestic consumptions, transit/transshipment or other purposes.

Guide to on-site checks and inspections by Customs

- ✓ All persons carrying out an activity involving the storage, working, processing, or sale or purchase of goods in FZs should keep appropriate records in a form approved by the Customs.

- ✓ Customs should monitor the movement of goods and persons in FZs and inspect incoming, placed and outgoing cargoes and baggage based on risk management techniques.
- ✓ Customs should have the authority to conduct on-site check and inspections on companies' premises both periodically and at any time when considered necessary by Customs.

Advanced inspection technologies

- ✓ Customs should establish and maintain surveillance systems at FZ entry and exit control points as well as inside FZs. For this purpose, Customs should use non-intrusive inspection (NII) equipment, surveillance cameras and other technologies to monitor cargoes and people.
- ✓ NII equipment should be installed according to a well-planned flow line of lorries and cargoes developed by Customs and other authorities at the construction stage.
- ✓ Customs should explore the possibility of utilizing advanced technologies, such as electronic tracking systems and e-seals, to monitor cargo movements inside and outside FZs.

Cooperation with the private sector and other governmental agencies

- ✓ Customs should establish and maintain cooperation mechanism with operators and companies, including measures such as periodic dialogue, reporting/information sharing, and the provision of adequate training.
- ✓ Through such periodic dialogue and information sharing, Customs, the private sector and other governmental agencies should work together to solve any issues and challenges in FZs.

Cooperation among Customs

- ✓ Customs should cooperate with each other by sharing information based on Customs Mutual Assistant Agreements (CMAA) for the purpose of combating illegal activities utilizing FZs.
- ✓ Customs should establish a contact point to facilitate such cooperation among Customs.
- ✓ Appropriate controls should be exercised on documentation as well as on the goods themselves, so as to identify and check the true origin of goods in FZs through cooperation with other governmental agencies and also through cooperation with Customs, by tracking the routes taken by cargoes.