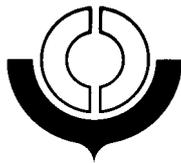


# **KYOTO CONVENTION**

## **GUIDELINES TO SPECIFIC ANNEX F**

### ***Chapter 2***

### ***OUTWARD PROCESSING***



WORLD CUSTOMS ORGANIZATION

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## **1. Introduction**

National legislation often provides for total or partial exemption from import duties and taxes on goods declared for home use which are obtained by manufacturing, processing or repair of temporarily exported goods in free circulation. The Customs procedure which provides for this exemption is outward processing.

## **2. Purpose and scope**

The main purpose of the outward processing procedure is to make it possible for national enterprises to reduce their production costs thereby making products available at more competitive prices. The term “processing” in this context may include packaging, packing or repacking of goods, in addition to the manufacturing and processing operations included in the definition of outward processing. The latter would also cover goods that undergo minor operations.

The application of this procedure may be made subject to the condition that the processing operations envisaged are not detrimental to national interests. The exemption granted on goods that are imported after processing abroad is usually partial. However it may be total, particularly where repairs have been carried out abroad free of charge. Duties and taxes in this context also include internal taxes levied on the importation of goods, such as Value Added Tax or Goods (VAT) and Services Tax (GST).

## **3. Essential Features**

The outward processing procedure makes it possible to temporarily remove goods from the Customs territory which are there in free circulation. Compensating products resulting from the outward processing operations abroad can then be imported with total or partial exemption from import duties and taxes.

Thus, unlike goods under the outright exportation procedure, goods in free circulation in the Customs territory which are temporarily exported are, on their return to the Customs territory (after having been repaired, manufactured or incorporated into other goods), continue to be regarded as goods in free circulation to which import duties do not apply (totally or partially).

For that reason, goods exported temporarily must be subject to suitable identification measures making it possible to establish that the compensating products were obtained totally or partially from the temporarily exported goods.

At exportation it is essential that the goods be declared for the outward processing procedure. The export declaration is both an instrument by which the exporter states that he wants the goods to be placed under the outward processing procedure and a formality enabling Customs to carry out any necessary controls.

In some administrations this procedure is also applied to goods that were in the Customs territory under the inward processing procedure. In these administrations the

exported goods or compensating products on subsequent re-importation can be placed again under the inward processing procedure.

These Guidelines are aimed at developing general principles governing the outward processing procedure, the formalities to be completed under the normal procedure, and ways of simplifying the formalities and/or procedures. Some countries provide for the use of a “replacement system” when the processing operation consists of repairing the goods. (See Appendix I.)

These Guidelines do not cover the provisions governing outright exportation.

## **4. Definitions**

**E1/F2**     ***"compensating products"** means the products obtained abroad and resulting from the manufacturing, processing or repair of goods for which the use of the outward processing procedure is authorized;*

**E2/F1**     ***"outward processing"** means the Customs procedure under which goods which are in free circulation in a Customs territory may be temporarily exported for manufacturing, processing or repair abroad and then re-imported with total or partial exemption from import duties and taxes.*

All the definitions of terms necessary for the interpretation of more than one Annex to the Convention are placed in the General Annex. The definitions of terms applicable to only a particular procedure or practice are contained in that Specific Annex or Chapter.

## **5. Principle**

### **Standard 1**

*Outward processing shall be governed by the provisions of this Chapter and, insofar as applicable, by the provisions of the General Annex.*

The revised Kyoto Convention has a set of obligatory core provisions that are contained in the General Annex. The General Annex reflects the main principles considered necessary to harmonize and simplify all the relevant Customs procedures and practices which Customs apply in their daily activities.

As the core provisions of the General Annex are applicable to all Specific Annexes and Chapters, they should be applied in full for Outward processing. Where a specific applicability is not relevant, the general facilitation principles of the General Annex should always be borne in mind when implementing the provisions of this Chapter. In particular, Chapter 1 of the General Annex on general principles and Chapter 4 on duties and taxes should be read in conjunction with this Chapter on Outward processing.

Contracting Parties should particularly note Standard 1.2 of the General Annex and ensure that their national legislation specifies the conditions to be fulfilled and the formalities to be accomplished for Outward processing.

In line with Article 2 of the Convention, Contracting Parties are encouraged to grant greater facilities than those provided for in this Chapter.

### **Recommended Practice 2**

*Outward processing should not be refused solely on the grounds that the goods are to be manufactured, processed or repaired in a given country.*

This Recommended Practice is intended to prevent any discrimination in applying the Customs formalities for outward processing because of the country where the outward processing is to be done.

Contracting Parties are authorized by Article 3 of the Convention to apply all prohibitions and restrictions deriving from their national legislation. However, in the particular case of goods that are in free circulation and are exported for outward processing, Contracting Parties are encouraged not to apply prohibitions and restrictions because of the country to which the goods are being sent for the outward processing.

This does not prevent Customs administrations from varying the degree of Customs control upon the return of the goods for home use. However in exercising this control function, Customs administrations should use risk management techniques as described in Chapter 6 of the General Annex and the related Guidelines.

## **6. Formalities to be completed under the normal procedure**

### **6.1. Field of application**

#### **Standard 3**

*Temporary exportation of goods for outward processing shall not be restricted to the owner of the goods.*

In general, use of the outward processing procedure is granted to the person carrying out the outward processing operations, who need not necessarily be the owner of the goods.

In practice, the procedure is used essentially by contractors. The authorization holder is the “contractor” who organizes the processing operations and, after the goods have been exported and processed abroad, declares the imported compensating products for home use.

## 7. Placing goods under outward processing

### 7.1. Authorization

#### Standard 4

*National legislation shall enumerate the cases in which prior authorization is required for outward processing and specify the authorities empowered to grant such authorization. Such cases shall be as few as possible.*

In many administrations an authorization for the outward processing procedure must be obtained from a competent authority. This competent authority may be Customs or another governmental agency empowered to approve such authorizations based on economic policy (e.g. the government department responsible for economic affairs or external trade). However, Customs will ensure that all the conditions required for the procedure are fulfilled and will issue the authorization.

#### Conditions for granting authorization

The following conditions usually must be met in order to be granted an authorization :

- The persons carrying out the processing operations must generally be established in the Customs territory;
- It must be possible to establish that the compensating products will result from processing of the temporarily exported goods; and
- The “economic conditions” below must be met.

Customs must ensure that all the conditions required for granting an authorization are fulfilled.

#### (a) The economic conditions

Authorization for the outward processing procedure is not granted when the planned operations are likely to seriously damage the vital interests of national processors or producers.

In the case of outward processing, a country’s economic interests are difficult to establish, because although this procedure generally favours employment abroad it also reduces the production costs of national manufacturers.

A balance must therefore be found in this respect between a maximum reduction in the total production costs of national operators through sub-contracting abroad as opposed to keeping the processing operations for other national operators at the risk of reducing the national industry’s competitiveness.

As total exemption from import duties and taxes applies only in the case of certain repairs free of charge, the economic conditions are essentially examined in all the other cases where the application of partial taxation already provides some protection.

**(b) Issuing the authorization**

The authorization is issued by Customs at the request of the person who carries out the processing operations or who arranges for them to be carried out. A request for the authorization can be made :

- by a standard request or
- by a simplified request.

***Standard request***

For a standard request the authorization is obtained in advance, before the goods can be placed under the outward processing procedure. A standard request is generally applicable for persons who have the intention of carrying on large-scale or continuous outward processing operations.

The following may be required in the application form and be approved of in the authorization itself :

- Name or business name and address of the applicant.
- Information on the goods to be processed :
  - The trade and/or technical description. The description should be sufficiently clear and detailed to enable a decision to be taken on the application. The description should entail enough particulars to enable Customs to check on the use of the authorization, with particular reference to the expected rates of yield.
  - Indication of the tariff classification.
  - Estimated quantity stated by reference to exports over a given period.
  - Estimated Customs value stated by reference to exports over a given period.
- information on the compensating products and planned import operations :
  - The trade and/or technical description. The description for each compensating product obtained should be sufficiently clear and detailed to enable a decision to be taken on the application. The description should entail enough particulars to enable Customs to check on the use of the authorization, with particular reference to the expected rates of yield.
  - Indication of the tariff classification (for each compensating product to be obtained);
  - The main compensating products;
  - The planned import operations.
  - Expected rate of yield or method of how such rate should be established by Customs.

- Description of the nature of processing operations to be carried out on the exported goods in order to produce the compensating products.
- Estimation of time needed :
  - Indication of the average time needed to carry out the processing operations for a given batch of the goods (expressed by unit or quantity, for example);
  - Indication of the time likely to elapse between completion of the processing operations and import of the compensating products (period of re-importation);
- Indication of the most suitable method(s) of identifying the foreign goods in the compensating products.
- Suggested Customs office which would be suitable as the :
  - Customs office responsible for the supervision of the procedure;
  - Customs office where the Goods declaration for outward processing can be accepted;
  - Customs office of discharge where the Goods declaration for the appropriate Customs procedure can be accepted.
- Indication of the period which is planned to export goods temporarily for outward processing (intended duration of the authorization).

### ***Simplified request***

A simplified request for the authorization is made by lodging the Goods declaration for outward processing. This is normally applied in situations where the importer intends to carry out a single and unique outward processing and where controlling the processing operations can be done quite easily.

A simplified request may also be limited to situations in which the outward processing has little economic impact, e.g. operations involving goods of a non-commercial nature or for repair.

Where a simplified request for the outward processing procedure is permitted, Customs should accept the lodging of the Goods declaration for the outward processing procedure as an application for authorization. In this case, Customs' registering of the Goods declaration constitutes the authorization and subjects the goods to the conditions governing the authorization.

Where the information in the Goods declaration does not contain all the information necessary to grant the authorization for outward processing, Customs may require that the declarant submit a separate document containing the following information :

- the name or business name and address of the applicant where the person applying to use the procedure is not the same as the declarant;
- the nature of the processing operation;
- the trade and/or technical description of the compensating products;

- the estimated rate of yield or, where appropriate, the method by which that rate is to be determined;
- the estimated period for importation; and
- the country where it is intended to carry out the processing operation.

In the case of Customs or Economic Unions, when goods are to be exported from several countries belonging to the same Customs territory, a single authorization may be issued by Customs of one of those countries and it is valid for the other countries from which the goods will be temporarily exported.

In principle, authorizations take effect on the date of issue.

The duration of an authorization's validity is generally set by Customs according to the economic conditions and taking account of the specific needs of the applicant. These conditions may be re-examined periodically at intervals specified in the authorization.

### **Control and audit**

Control and audit are described in Chapter 6 of the General Annex and its Guidelines. The circumstances in which outward processing is allowed mainly concern the possibility of determining the presence of foreign goods in the compensating products, the time limits for outward processing and the obligations of persons who export goods under this procedure.

### **Examination of the goods**

The examination of goods is dealt with in Chapter 3 of the General Annex and its Guidelines. Examination of the goods generally takes place at the Customs office where the Goods declaration for the compensating goods is lodged.

Examination of the goods at the premises of the person concerned should be allowed, for example, when it would facilitate the examination or when the nature of the goods is such that examination at the Customs office would be inconvenient. Obviously Customs will be able to allow inspection on private premises only to the extent that examining officers can be made available for the work.

Customs may require that goods for examination at the premises of the person concerned be transported under Customs seal or some other form of control from the office of importation to the place of destination.

### **Recommended Practice 5**

*Persons who carry out regular outward processing operations should, on request, be granted a general authorization covering such operations.*

Granting of a general authorization for traders who perform continuous outward processing operations is a measure of facilitation to both the trader and Customs. Such traders will normally have established good records of compliance with Customs law and therefore can be eligible for less Customs intervention for each individual transaction. For Customs this reduces the manpower and paperwork requirements for reviewing and granting multiple individual authorizations. The general authorization may be made subject to the condition that the goods held under outward processing should not exceed a certain quantity and that the processing operations should be completed within a prescribed time limit.

## **7.2. The rate of yield**

### **Recommended Practice 6**

*The competent authorities should fix a rate of yield for an outward processing operation when they deem it necessary or when it will facilitate the operation. The description, quality and quantity of the various compensating products shall be specified upon fixing that rate.*

The rate of yield indicates the quantity of compensating products normally obtainable from the goods temporarily exported. In fixing this rate, account may be taken of losses resulting from the nature of the goods used.

When a rate of yield is fixed, the exporter knows what quantities can be re-imported under the procedure, or are required to be so re-imported. The latter case may arise if the temporary exportation is conditional upon re-importation of all the compensating products obtained.

The rate of yield is fixed by Customs taking account of the technical data for the processing operations abroad or, where applicable, data available within the country regarding similar operations.

In some administrations, standard rates of yield may be fixed where the outward processing operations :

- relate to goods whose characteristics remain reasonably constant;
- are customarily carried out under clearly defined technical conditions; and
- give compensating products of constant quality.

Generally, the rate of yield is fixed at the time of placing the goods under the procedure. However, when circumstances so justify, it can be fixed at the latest, at the date of registering the declaration for home use for the compensating products.

## **7.3. Identification measures**

### **Standard 7**

*The requirements relating to the identification of goods for outward processing shall be laid down by the Customs. In carrying this out, due account shall be taken of the nature of the goods, of the operation to be carried out and the importance of the interests involved.*

Customs must ensure that it is possible to establish that the compensating products were manufactured using the temporarily exported goods, especially by making use of, as applicable :

- (a) the reference to or description of the specific manufacturing marks or numbers;
- (b) seals, stamps or other individual marks;
- (c) samples, illustrations or technical descriptions;
- (d) analyses;

- (e) documentary evidence concerning the operations envisaged (such as contracts, correspondence, invoices) clearly showing that the compensating goods are to be manufactured from temporarily exported goods.

## **8. Stay of the goods outside the Customs territory**

### **Standard 8**

*The Customs shall fix the time limit for outward processing in each case.*

Customs must specify the period within which the compensating products must be imported. This period should take account of the time required to carry out the processing operations, as well as the economic conditions in the Customs territory and the specific needs of the applicant. The period normally will begin on the date of registration of the export declaration for the outward processing procedure.

It may not be necessary for the maximum time limit fixed in each case to be automatically granted at exportation. For example, if national legislation lays down a time limit of one year for the outward processing of goods intended for repair, it may not always be appropriate to grant this maximum time limit, particularly in cases where the proposed repairs are only minor.

For reasons of simplification, a period that commences in the course of a calendar month or quarter could be ended on the last day of a subsequent calendar month or quarter.

If a general time limit for outward processing is fixed instead of an individual time limit for each particular case, this may be regarded as granting a greater facility.

### **Recommended Practice 9**

*At the request of the person concerned, and for reasons deemed valid by the Customs, the latter should extend the period initially fixed.*

Whenever a duly substantiated request by the holder of the authorization to extend the time limit is submitted, Customs should grant the extension. Where the circumstances so warrant, Customs is also encouraged to extend the time limit even when the time limit originally set has expired.

## **9. Importation of compensating products**

### **Standard 10**

*Provision shall be made to permit compensating products to be imported through a Customs office other than that through which the goods were temporarily exported for outward processing.*

The basic features of the procedure whereby compensating products are cleared for home use are the same as those laid down for any other home use operations. In addition Customs will have to satisfy themselves as to the identity of the compensating products.

Generally speaking, the declaration for home use is lodged with one of the offices specified in the authorization. However, the competent authorities may allow the declaration to be presented at another Customs office.

When a Customs territory is made up of several countries (for example, a Customs or Economic Union), triangular traffic should be authorized. Triangular traffic is the method by which the compensating products under the outward processing procedure are cleared for home use in a country other than that where the goods were temporarily exported.

This system is subject to compliance with certain rules for procedures permitting information exchange between the Customs of the countries concerned.

#### **Standard 11**

*Provision shall be made to permit compensating products to be imported in one or more consignments.*

For logistical and other commercial reasons, persons who have sent goods for outward processing may need to import the compensating products in more than one consignment, and Standard 11 requires Customs to permit such importation. Customs may take the necessary measures to ensure that the conditions and formalities pertaining to the outward processing procedure are complied with for each individual consignment. Such measures would include identification of the goods, reconciliation of records of imports and other verification measures.

#### **Standard 12**

*Upon request by the person concerned, the competent authorities shall allow goods temporarily exported for outward processing to be re-imported with exemption from import duties and taxes if they are returned in the same state.*

*This exemption shall not apply to import duties and taxes which have been repaid or remitted in connection with the temporary exportation of the goods for outward processing.*

For various commercial reasons goods which are temporarily exported for outward processing may return in the same state to the Customs territory of exportation. Such goods are covered under the scope of Standard 12 even if they are not processed. This exemption is conditional upon a request being made to Customs and that the goods are returned in the same state. However, the exemption will not apply if the import duties and taxes have been repaid or remitted at the time of exportation.

#### **Standard 13**

*Unless national legislation requires the re-importation of goods temporarily exported for outward processing, provision shall be made for terminating the outward processing by declaring the goods for outright exportation subject to compliance with the conditions and formalities applicable in such case.*

Generally the outward processing procedure will be terminated when the compensating products are imported for home use. However, there can be instances where the person concerned, for a variety of reasons, may decide not to import the compensating products. Standard 13 provides this economic and commercial flexibility and allows the outward processing to be terminated by declaring the goods for outright exportation, as long as there is no specific requirement in national legislation for the compensating products to be imported. In granting the outright exportation to terminate the outward processing, Customs should ensure that any related conditions and formalities, such as payment of export duties and taxes, are complied with.

Some administrations do not require the submission of an additional declaration for outright exportation and permit the request to be made on the outward processing documents. This can be regarded as granting a greater facility in accordance with Article 2 of the Convention.

## **10. Duties and taxes**

### **Standard 14**

*National legislation shall specify the extent of the exemption from import duties and taxes granted when compensating products are taken into home use, and the methods of calculation of that exemption.*

### **Recommended Practice 16**

*Where goods temporarily exported for outward processing have been repaired abroad free of charge, provision should be made for them to be re-imported with total exemption from import duties and taxes under the conditions laid down in national legislation.*

The outward processing procedure allows total or partial exemption from import duties at re-importation of the compensating products.

Total exemption generally applies when outward processing consists of free repair due to a contractual or legal guarantee obligation or the existence of a manufacturing fault, or else when it is so laid down by specific provisions in the framework of particular trade arrangements.

National legislation will provide for calculating the total or partial exemption using one of the following methods.

#### **10.1. Differential taxation method**

The rate of yield is a fundamental element in the authorization of outward processing, as it is necessary in order to calculate the amount of duties to be collected by application of the differential taxation method. It must ensure equal treatment between operators.

Differential taxation is the result of a difference in import duties and taxes and it is in the operator's interest to ensure that the amount to be deducted is as high as possible so that the amount to be paid is as low as possible. The operator could therefore export a quantity of goods in excess of that actually required for obtaining compensating products, so as to be able to deduct more duty when re-importing these products. That is why the rate of yield is necessary. This rate makes it possible to determine the quantity of temporarily exported goods actually required to obtain the compensating goods.

The differential taxation method is closely linked to the "further worked" principle inherent in the tariff, according to which, in many cases, the Customs duties increase proportionately with the degree to which the product is worked. In this case, the exported goods are, in principle, subject to a lower Customs rate than that applicable to the further worked compensating product.

By virtue of this method, exemption from import duties and taxes consists of deducting from the amount of import duties and taxes on compensating products cleared for home use, the amount of import duties and taxes that would apply on the same date to the temporarily exported goods used to obtain the compensating products, if they were imported into the

Customs territory from the country where they were processed or underwent the last processing operation.

With differential taxation, the value of exported goods are included in the value of the compensating product; when re-imported, the exported goods are subject to higher duties in comparison to the Customs duties to be deducted. This represents an “over-taxation” of the national components and hence provides adequate protection of national interests, insofar as a high differential duty corresponds to a high need for protection of national industry, and vice versa. Thus, for example, no exemption is granted if there is a zero rate of Customs duties on the exported goods.

However, this protection mechanism does not always function in cases of tariff anomalies. Indeed, the use of the differential method could have the opposite effect if the exported goods are liable to a higher rate of duty than that applied to the compensating products.

## **10.2. Taxation method based on added value**

The calculation method based on *added value* should make it possible to calculate the exemption of duties under outward processing by deducting the value of the temporarily exported goods from the Customs value of the compensating products. With this method, the increase in value obtained by the processing operations carried out abroad is taxed, and there is no need to know the rate of duty applicable to the exported goods.

The added value calculation method has some obvious advantages. The amount of the exemption for outward processing is easier to calculate than with the differential taxation method, and the trader can clearly determine the profitability of using outward processing.

The disadvantage of this method is that it can only be applied to goods liable to ad valorem duty, and this rules out its use for products taxed on the basis of a specific rate or a combination of both ad valorem and specific rates.

### **Standard 15**

*The exemption from import duties and taxes provided for in respect of compensating products shall not apply to duties and taxes which have been repaid or remitted in connection with the temporary exportation of the goods for outward processing.*

The principle enumerated in Standard 12 also applies to this provision in that if import duties and taxes have been repaid or remitted on goods exported for outward processing, exemption from import duties and taxes will not apply to the compensating products upon importation. However some countries do not allow goods on which import duties and taxes have been repaid or remitted on export to be placed under the outward processing procedure.

**Recommended Practice 17**

*The exemption from import duties and taxes should be granted if the compensating products were placed under another Customs procedure prior to being declared for home use.*

**Recommended Practice 18**

*The exemption from import duties and taxes should be granted if the ownership of the compensating products is transferred before they are taken into home use.*

Normally when compensating products are imported, they are cleared for home use on payment of any duties and taxes that may be applicable. However, in many instances it is possible that the compensating products are placed under another Customs procedure before they are cleared for home use. Examples of such procedures are placing the goods in a Customs warehouse or free zone or under temporary admission.

Recommended Practice 17 requires that the exemption from import duties and taxes provided for in Standard 14 will also apply when the compensating products have been placed under another Customs procedure before terminating the outward processing procedure. However, if a time limit was fixed for importation of the compensating products, Customs may require that this time limit be respected even if the goods are placed under a Customs procedure other than home use.

Likewise, Customs should grant the exemption from duties and taxes for the compensating products regardless of whether the ownership of these goods has been transferred while they were under the outward processing procedure. For example, in normal commercial practice goods may be sold to another person during the outward processing procedure. The exemption, however, is on the goods themselves regardless of the person taking them into home use. This exemption from duties and taxes does not include any internal taxes that may become chargeable because of the transfer of ownership of the goods.

Customs would normally require that the goods be declared for home use in the name or for the account of the person who placed the goods under the outward processing procedure as a matter of control.

## **11. Simplified procedures**

### **11.1. Simplified procedures relating to the declaration for placing the goods under the procedure.**

Simplified procedures such as those developed in the Guidelines to Specific Annex C, Chapter 1 on outright exportation are applicable under the same conditions as the formalities to be completed for exporting goods under the outward processing procedure. The Guidelines on outright exportation should therefore be consulted in this regard.

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## Appendix 1

### Method of application

#### The European Community

##### **Outward processing using the replacement system**

In the European Community the competent authorities permit use of the "replacement system" when the processing operation consists of repairing the goods.

This system consists of substituting an imported good for a compensating product. It therefore makes it possible to import, instead of the compensating product, another product known as the "replacement product", while retaining the benefits of outward processing.

The replacement product must normally fall in the same subheading of the Customs tariff (in the European Community this is referred to as the Combined Nomenclature), be of the same commercial grade or quality and have the same technical characteristics as the temporarily exported goods if the latter had undergone a specified repair (*conditions of equivalence*).

If the temporarily exported goods were used prior to exportation, the replacement products must also have been used and cannot be new products. Derogations from this rule may be granted if the replacement product was delivered free of charge, either due to a contractual or legal guarantee obligation, or as a result of a manufacturing defect.

The competent authorities also permit, under conditions set by them, replacement products to be imported prior to exportation of the temporarily exported goods (*prior importation*).

Prior importation of a replacement product may require provision of security for the amount of the import duties.

The replacement system cannot be used to improve the technical performance of the goods.

Use of the replacement system is accepted when it is possible to check compliance with the conditions of equivalence between the replacement products and the compensating products which should have been imported.

Under the replacement system without prior importation, the time limit is determined taking account of the time required to substitute the temporarily exported goods and to transport the temporarily exported goods and the replacement products.