

## INTRODUCTION TO IMPORTING

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## METHODS OF PAYMENT

- Letters of credit
  - Sight and term drafts and open account
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### LETTERS OF CREDIT

Letters of credit (L/C) are a method of payment used frequently. This method has certain advantages and disadvantages.

A letter of credit is in essence a promise made by an importer to an exporter to the effect that the exporter will be paid upon production of certain documents. This promise is normally transmitted through (and backed up by) a bank.

For example, an importer will state in a letter of credit that he undertakes to pay US\$50,000 for five cars, provided the exporter produces evidence that they have been placed on board a direct ship before the end of December. This letter is also signed by the importer's bank, which immediately assumes liability for paying the US\$50,000 to the exporter, as soon as he is able to comply with the conditions. For this reason, banks treat letters of credit as no different from any other credit facilities and will allocate ceilings to applicants, like they do with overdraft limits.

On the 28th of December, the exporter produces an on-board bill of lading to his bank in Japan and the amount of US\$50,000 is credited to his account. The Japanese bank recovers that amount from the New Zealand bank that in turn debits the importer's account. The Japanese bank sends the bill of lading to the New Zealand bank who passes it on to the importer, so as to enable him to take possession of the goods.

It is also possible that, instead of the various payments taking place against production of documents, the letter of credit states that they will take place at some future date, say 30 days. In these cases, the banks will be pleased to oblige, as long as they get the interest, which may be payable by the importer or the exporter, depending on the terms of the L/C.

It is therefore easy to see how letters of credit protect exporters and importers alike. However, we must not forget that they deal with documents and nothing else. For example, if the cars were shipped without engines, there is no way that the banks would accept any responsibility, since all the documents would still be correct. It is, however, possible to demand certificates of inspection by independent third parties, where such verification is important.

Banks will charge quite hefty fees for the provision of these services. Because the security of the transaction revolves around the physical possession and endorsement of the bill of lading, delays in transmission will frequently cause demurrage at destination. It is therefore important that L/Cs are only used when such protection is required. There is obviously no point in using this rather complex and costly system when the protection that it affords is not really needed.

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- *L/Cs provide the highest level of security, but are expensive and can cause delays.*

## SIGHT AND TERM DRAFTS

A simpler method of undertaking international transactions is that of bank draft against documents. This simply means that the importer must instruct his bank to transfer funds to the exporter before the bank will let him have the documents. This provides some measure of security to the exporter, but not as much as an L/C.

The importer has the option of simply refusing to accept the draft, in which case he cannot take possession of the goods, but neither does the exporter receive payment. In cases where the importer's business collapses, the exporter can be left exposed.

Drafts can also be drawn at sight – i.e. payment is made on the spot, or subject to terms. If a term is specified, the banks will recover interest in accordance with the terms of the draft.

## OPEN ACCOUNTS

This is the method used by most companies who have transactions with associated companies or where there are no issues of security – for example, long standing trading relationships developed on the basis of mutual trust. This method, incidentally, is that used for most domestic transactions in New Zealand.

Most companies will extend credit terms to their clients, subject to them meeting certain criteria. While this is the most efficient and less costly option, it also entails the biggest level of risk. Many traders are prepared to accept those risks domestically, but are reluctant to do so internationally, where debt recovery can be more complicated.

Some exporters will simply demand payment in advance before they will ship the goods. This way, the importer assumes all the risks.

The selection of the method of payment is in essence a function of risk assessment. There are substantial penalties for seeking too much security (in the form of delays and charges) and equally substantial penalties for running an unacceptable level of risk.

Our advice is to look at these matters from a risk assessment perspective and then decide on the best method. In our experience, many importers and exporters use L/Cs which are not justified by the risks involved but simply because "that is the way it has always been done".

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- *Drafts and open accounts are simpler and less expensive than L/Cs, but less secure.*
  - *The selection of method of payment is a risk assessment decision.*

## IMPORT DOCUMENTATION

- Commercial invoices and certificates of origin
  - Bills of lading and waybills
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### COMMERCIAL INVOICES AND CERTIFICATES OF ORIGIN

Commercial invoices can be produced in any format. There is no longer a requirement for "Customs Invoices". However, it is important that invoices contain sufficient information to identify the goods.

When the invoice price includes freight and insurance, it would be useful if the amounts of freight and insurance included in that price were listed on the invoice.

In the past, New Zealand Customs required the presentation of a certificate of origin before a preferential tariff could be claimed, for example from Australia or developing countries. This requirement is no longer current.

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- *Commercial invoices should clearly identify the goods*
- *Certificates of origin are no longer required*

## BILLS OF LADING, WAYBILLS AND LETTERS OF INDEMNITY

Bills of lading (B/L) have two major functions: (1) a receipt by the shipping company for the goods; and (2) a legal document of title. This latter aspect is important only when you use the banking system to secure payment against shipment.

However, most trade is now undertaken between subsidiaries of the same organisation or between parties who know and trust each other. In these cases there is no need to use the bill of lading for the purposes of security.

The delays in receiving original bills of lading through the banking system are probably the largest single cause of delays at destination. It is therefore important to consider the alternatives.

Sea waybills, also known as "express release" or "telex release" bills of lading, can be used when there is no need to rely on the payment protection afforded by bills of lading. Shipping companies will release cargo against production of a fax of these documents.

Letters of indemnity can be produced when the original bill of lading fails to arrive before the goods. A letter of indemnity is simply a promise by the importer that he will not hold the shipping company responsible for any claims arising from their decision to allow delivery of the cargo without an original B/L and will indemnify the shipping company against any such claims received from other parties – e.g. the exporter.

There are several types of letters of indemnity. Some shipping companies will insist on importers using only their forms, while others will accept a "general" form. Some shipping companies will insist on those letters being counter-signed by a bank while others will be satisfied with an undertaking from the importer alone.

Some will insist on seeking prior authorisation from the overseas exporter, while others will not. There is also a variation of this system whereby the shipping company (or a forwarder) will accept a "permanent" indemnity. This facility is provided as a service by some forwarders to importers whom they know and trust.

When a bank countersigns the letter of indemnity, it is most important that the bill of lading, when it appears, is exchanged for the letter of indemnity so as to enable it to be released at the bank.

Air waybills, on the other hand, are not negotiable documents of title. A degree of negotiability can be attained by the exporters consigning the waybills to the importers' banks.

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- *Can you use non-negotiable waybills instead of bills of lading?*
  - *Negotiate letter of indemnity facilities with forwarders.*

## TARIFFS AND CONCESSIONS, VALUATION AND ORIGIN

- Tariffs and concessions
  - Tariff classification
  - Valuation and Origin
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### TARIFFS AND CONCESSIONS

The following is an extract from the New Zealand tariff:

<b>94.03</b>	<b>Other furniture and parts thereof:</b>
9403.10	– Metal furniture of a kind used in offices:
[...]	
9403.20	– Other metal furniture:
9403.20.10	– – Music and drafting stands
9403.20.19	– – Other

The international structure stops at the six-digit level. The number 9403.20 applies to metal furniture (other than that used in offices) in any of the countries that use this system. In New Zealand, this sub-heading was further sub-divided into 9403.20.10 (music and drafting stands) and 9403.20.19 (other). This was done to create a duty-free category for the music stands, while all other furniture became subject to duty. In Australia, for example, different sub-divisions would have been created to suit their conditions.

In addition, duty concessions for individual products or categories can be found in a separate schedule (Ministerial Decisions) which should be consulted, but only after the goods have been classified in the main schedule. For example, under the dutiable tariff item, the following concession is listed:

*300403B – Speaker and/or lighting stands*

These specific goods come in duty free, even though they are classified in a dutiable tariff item. This is because their importers made applications to Customs on the grounds that those goods have no locally made equivalents.

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- *The tariff is based on an international structure.*
- *Each country creates sub-divisions below six-digit level.*
- *In addition, there are concessions for individual products.*

## VALUATION AND ORIGIN

New Zealand subscribes to the WTO code for the valuation of goods. In essence this means that goods must be valued for Customs purposes according to the price for which they are actually traded. This replaces the previous system where Customs made decisions on the value for duty based on what the goods were sold for in their home market.

The vast majority of goods imported are simply valued according to the invoice price. However, there are some important exceptions. When the buyer and seller are related, for example two branches of the same trans-national company, it is important to establish that the relationship does not affect the price. Normally this is evidenced through the production of invoices showing that similar prices are also charged to companies outside the group.

It is also important to ensure that the value declared to Customs includes amounts which are payable but may not be shown on the invoices – e.g. periodical payments for royalties.

On the other hand, there are a number of deductions that are legally allowed.

Goods can also be subject to lower tariffs or become duty-free as a result of the country of origin – for example goods from developing countries normally have lower duties and all goods qualifying for Australian origin are admitted duty-free.

In order to qualify for preferential origin, however, the goods must meet certain requirements, which vary according to the country or trade agreement involved.

Importers will sometimes assume that goods that they purchase in Australia will automatically qualify for duty-free entry under CER. This is not so. For example, a garment made in Australia from fabric imported from Italy may not qualify as the price of the fabric may exceed the cost of manufacture. One common mistake made by importers is to base their calculation on price instead of cost. This distinction is important as it excludes items such as profit and overheads from the calculations. Only actual manufacturing costs (that can be evidenced) can be taken into account.

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- *The value for Customs is usually the value of the transaction.*
  - *Royalties and other amounts paid after importation are usually dutiable.*
  - *Under trade agreements, goods may have lower duties, but subject to origin rules.*

# CUSTOMS CLEARANCE

- Documentation required
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## DOCUMENTATION REQUIRED

To clear goods through Customs in New Zealand, you need a commercial invoice and a copy of the bill of lading or air waybill, or the information which is contained in those documents.

You do not normally need certificates of origin, packing lists, certificates of insurance, bank drafts or other documents.

The requirement to produce a certificate of origin for every shipment that claims a lower tariff based on the origin of the goods (for example Australia, developing countries) no longer exists. However, Customs can still demand the production of evidence of origin for any one shipment and this could be in the form of a certificate, a letter from the supplier or simple visual inspection of garment labels, for example.

Packing lists can be of assistance when, for example, the goods are subject to a physical examination. Customs may on occasions require the production of evidence of payment, for example copies of bank drafts or letters of credit.

However, these requirements are the exception and should be treated as such – i.e. there is no need to request from suppliers the production of these documents with every shipment and their absence should certainly not be used to delay the start of the clearance process.

Customs will accept photocopies or faxes of all documents. This means that there is no need to wait for (a) the documents to arrive from the bank or (b) the arrival of the flight, before you can undertake the clearance.

Customs will also accept declarations that are based on the information contained in those documents, even when the documents themselves cannot be produced at the time of entry. The typical example of this is when a declaration (entry) is prepared from information contained in an electronic message.

It is also possible to use information of a type normally found on waybills but received before the waybill is available, for example a fax or email received directly from the overseas supplier or freight forwarder.

To achieve clearance before the arrival of the goods should be a primary objective of every shipping manager.

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- *Minimum information: invoice and B/L or waybill.*
- *It is the information that is required, not the documents.*
- *Faxes and email messages are acceptable.*
- *Certificates of origin no longer required for every shipment.*

## TERMS

Incoterms are a set of definitions from the International Chambers of Commerce which define the responsibilities of importers and exporters. The following is simplified table listing some of the more commonly used terms.

	ORIGIN CARTAGE	INT'L FREIGHT	DESTINATION CARTAGE
EXW - Ex works			
FOB - Free on board			
CFR - Cost and Freight and CIF			
DDP and DDU - Delivered (with duty Paid or Unpaid)			

 = EXPORTER PAYS