

## Chapter 2

### Key provisions of the Bills

2.1 This chapter examines the provisions of the Customs Bill and the Tariff Bill and compares them with the corresponding articles of KAFTA. The committee recognises that the Bills are not intended to give full effect to all of Australia's obligations under KAFTA, but rather certain obligations contained in Chapter 3 and Annex 2-A of KAFTA.

2.2 The committee also recognises that two other parliamentary committees have already inquired into KAFTA as a whole.

2.3 As the Bills considered in this inquiry relate only to a small part of the agreement, the committee has limited its examination of KAFTA to those articles to which the Bills seek to give domestic effect. Unfortunately, the explanatory memoranda do not clearly set out which provisions of the Bills are intended to give effect to which provisions of KAFTA; it would have greatly assisted the committee if they had.

#### *Note on terminology*

2.4 KAFTA imposes obligations on both Korea and Australia, but the Bills would give effect only to Australia's obligations. For this reason, the language used in the Bills is often markedly different to that which appears in KAFTA. For example, article 3.1 of KAFTA defines when a good shall be regarded as originating in Korea or Australia, but proposed Division 1J in the Customs Bill defines only when a good shall be regarded as originating in Korea. This is because Australia's tariff reduction obligations under KAFTA only apply to goods that originate in Korea (and not to goods that originate in Australia). Furthermore, the terminology used in KAFTA and the Bills also differs because of the stylistic differences between a treaty and Commonwealth legislation. Where these are the only differences between the corresponding provisions of KAFTA and one of the Bills, the latter will be described in this chapter as replicating the former 'with the appropriate adjustments'.

### **The Customs Bill**

2.5 As noted in the previous chapter, the main purpose of the Customs Bill is to amend the *Customs Act* to give domestic effect to parts of Chapter 3 of KAFTA. The amendments made by the Customs Bill to the *Customs Act* are contained in Schedule 1 to the Customs Bill, which is in three parts:

- Part 1 would insert a new Division 1J into Part VIII of the *Customs Act*, the main purpose of which is to define the phrase 'Korean originating goods';
- Part 2, which is entitled 'Verification powers', would insert a new Division 4G into Part VI. It provides for obligations to be imposed on persons who export goods to Korea (or who produce goods that are exported to Korea) that are claimed to be 'Australian originating goods' for the purposes of obtaining tariff reductions in Korea; and

- Part 3, which provides for the application of Parts 1 and 2.

2.6 Chapter 3 of KAFTA is entitled 'Rules of Origin and Origin Procedures'. It is divided into two sections: Section A is entitled 'Rules of Origin' and Section B is entitled 'Origin Procedures'. Each section is divided into a number of articles.

### ***Rules of Origin***

2.7 Part 1 of Schedule 1 of the Customs Bill (proposed Division 1J) aims to give domestic effect to parts of Section A of Chapter 3 of KAFTA. The central provision of Section A is article 3.1, which provides that 'a good shall be regarded as originating in a Party [to the agreement (that is, Korea or Australia)] where:

- (a) the good is wholly obtained in the territory of one or both of the Parties within the meaning of Article 3.2;
- (b) the good is produced entirely in the territory of one or both of the Parties, exclusively from originating materials;
- (c) the good satisfies all applicable requirements of Annex 3-A, as a result of processes performed entirely in the territory of one or both of the Parties by one or more producers; or
- (d) the good otherwise qualifies as an originating good in accordance with this Chapter.

2.8 Article 3.1 has no directly corresponding provision in the Customs Bill, but proposed section 153ZMA (the 'Simplified outline' of Division 1J) makes it clear that proposed Division 1J is intended to give effect to article 3.1. It provides as follows:

- This Division defines Korean originating goods. Preferential rates of customs duty under the Customs Tariff Act 1995 apply to Korean originating goods that are imported into Australia.
- Subdivision B provides that goods are Korean originating goods if they are wholly obtained in Korea or in Korea and Australia.
- Subdivision C provides that goods are Korean originating goods if they are produced entirely in Korea, or in Korea and Australia, from originating materials only.
- Subdivision D sets out when goods are Korean originating goods because they are produced entirely in Korea, or in Korea and Australia, from non-originating materials only or from non-originating materials and originating materials.
- Subdivision E provides that goods are not Korean originating goods under this Division merely because of certain operations.
- Subdivision F deals with other matters, such as how the consignment of goods affects whether the goods are Korean originating goods.

### ***Definitions***

2.9 Proposed section 153ZMB sets out the definitions that would apply to proposed Division 1J (in addition to the definitions in section 4 that apply to the whole of the *Customs Act*). The definitions that apply to Chapter 3 of KAFTA are to be

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found in article 3.30 of the agreement (in addition to the 'General Definitions' set out in article 1.4).

2.10 Proposed section 153ZMB defines 'produce' to mean 'grow, mine, harvest, fish, breed, raise, trap, hunt, manufacture, process, assemble or disassemble'. Article 3.30 defines 'production' to mean 'any kind of working or processing, including growing, mining, harvesting, fishing, breeding, raising, trapping, hunting, manufacturing, assembling or disassembling a good'. The definition in the Customs Bill appears to be narrower than the definition in KAFTA because the former does not include the general words 'any kind of working or processing'. This could lead to inconsistent interpretations of the Customs Bill and KAFTA, since the concept of production is relied upon in the Customs Bill's explanation of the three key ways in which goods can be considered 'Korean originating goods' and therefore eligible for tariff concessions.

*Subdivision B: wholly-obtained goods*

2.11 According to the simplified outline in proposed section 153ZMA, 'Subdivision B provides that goods are Korean originating goods if they are wholly obtained in Korea or in Korea and Australia'.

2.12 Proposed subsection 153ZMC(1) provides that goods are 'Korean originating goods' if they are 'wholly obtained in Korea or in Korea and Australia' and if the relevant certification requirements have been complied with. Proposed subsection 153ZMC(2) sets out twelve circumstances in which goods would be considered to be 'wholly obtained in Korea or in Korea and Australia'.

2.13 This section aims to give effect to article 3.1(a) in KAFTA, which refers to article 3.2 and the list of twelve circumstances therein in which goods shall be considered to be 'wholly obtained in the territory of one or both of the Parties'.

*Subdivision C: goods produced in Korea, or in Korea and Australia, from originating materials*

2.14 According to the simplified outline, 'Subdivision C provides that goods are Korean originating goods if they are produced entirely in Korea, or in Korea and Australia, from originating materials only'.

2.15 Proposed section 153ZMD provides that goods are 'Korean originating goods' if 'they are produced entirely in the territory of Korea, or entirely in the territory of Korea and the territory of Australia, from originating materials only' and if the relevant certification requirements have been complied with. Proposed section 153ZMB defines 'originating materials' to mean:

- (a) Korean originating goods that are used in the production of other goods;
- or
- (b) Australian originating goods that are used in the production of other goods; or
- (c) indirect materials.

2.16 The definition of 'Korean originating goods' is the subject of proposed Division 1J (see paragraph 2.7). 'Australian originating goods' and 'indirect materials' are defined in proposed section 153ZMB.

2.17 Proposed section 153ZMD is intended to implement article 3.1(b) of KAFTA, which provides that 'a good shall be regarded as originating in a Party where...the good is produced entirely in the territory of one or both of the Parties, exclusively from originating materials'. The definition of 'produced' has been considered above. As for the phrase 'originating materials': article 1.4 defines 'originating' to mean 'qualifying under the rules of origin set out in Chapter 3 (Rules of Origin and Origin Procedures)'; 'material' is defined in article 3.30.

2.18 Article 3.11 of KAFTA requires that indirect materials be treated as originating. The definition of 'indirect materials' in the Customs Bill appears to be equivalent, but not identical, to the definition in KAFTA.

*Subdivision D: goods produced in Korea, or in Korea and Australia, from non-originating materials*

2.19 According to the simplified outline, 'Subdivision D sets out when goods are Korean originating goods because they are produced entirely in Korea, or in Korea and Australia, from non-originating materials only or from non-originating materials and originating materials'.

2.20 Proposed subdivision D and the associated regulations would give domestic effect to article 3.1(c) of KAFTA, which provides that 'a good shall be regarded as originating in a Party where...the good satisfies all applicable requirements of Annex 3-A, as a result of processes performed entirely in the territory of one or both of the Parties by one or more producers'. Annex 3-A sets out the specific rules that would apply to specific products. There are six product-specific rules, of which:

- Three are 'change in tariff classification' rules. These require materials that do not originate in Korea or Australia to undergo a specified degree of change in their tariff classification as a result of processes undertaken in Korea or Australia in order for the final product to be considered to have originated in Korea or Australia. There is a 'de minimis' exception for materials that make up less than 10% of the 'adjusted value' of the final product;<sup>1</sup>
- Two are 'regional value content' rules. They provide that domestic materials and processes must make up a certain percentage of the value of the final product in order for the product to be considered as originating in the country in which the materials were sourced or the processes took place; and
- One requires the good to be wholly obtained within the territory of one or both parties.

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1 Article 3.6 of KAFTA provides that, if less than 10% of the 'adjusted value' of a good is attributable to non-originating materials that do not go through enough of a tariff classification change, the product will nonetheless be considered an originating product. The calculations for 'adjusted value' are provided for in article 3.3.1.

2.21 Proposed subsection 153ZME(1) provides that goods are of Korean origin if: (a) they are classified in the schedule to the Customs (Korean Rules of Origin) Regulation 2014 (which will incorporate the product-specific rules in KAFTA)<sup>2</sup>; (b) they are produced entirely in Korea or entirely in Korea and Australia; (c) the requirements contained in the regulations are satisfied; and (d) the certification procedures are complied with.

2.22 Proposed subsections 153ZME(2) to 153ZME(6) set out the requirements that would apply to goods that undergo a change in tariff classification by reason of some production process. By proposed subsections 153ZME(2) and 153ZME(3), the detail of these requirements is largely left to the regulations.

2.23 Proposed subsection 153ZME(4) aims to give effect to the 'de minimis' exception to the change in tariff classification rules. This rule, in the Customs Bill, operates on the 'customs value' of the goods (which is defined in proposed subsection 153ZMB(1) as having the meaning given by section 159 of the *Customs Act*). The manner of calculating the 'customs value' in section 159 differs from the formula used in KAFTA in relation to the de minimis rule.<sup>3</sup> Given that proposed subsection 153ZMB(3) specifies that the 'value' (not 'customs value') of goods is to be calculated in accordance with the regulations and the Customs Bill EM states that '[t]he value of non-originating materials for the purposes of [section 153ZME] is to be worked out in accordance with the method that will be included in the Korean Regulations',<sup>4</sup> it would appear that proposed subsection 153ZME(4) should operate on the 'value' of the goods, rather than the 'customs value'.

2.24 Proposed subsections 153ZME(5) and 153ZME(6) aim to give effect to the exceptions to the de minimis rule, as set out in article 3.6.

2.25 Proposed subsections 153ZME(7) and 153ZME(8) aim to give effect to the regional value content rules. Again, this appears to be left largely to the regulations, but subsection (8) gives effect to article 3.8 insofar as it applies to calculations of the regional content value of goods.

2.26 Proposed section 153ZMF, which concerns the position of packaging materials and containers, gives effect to article 3.9 of KAFTA, with the appropriate adjustments.

#### *Subdivision E: non-qualifying operations*

2.27 According to the simplified outline, 'Subdivision E provides that goods are not Korean originating goods under this Division merely because of certain operations'.

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2 Customs Bill EM, p. 34.

3 Article 3.6 of KAFTA sets out the de minimis rule, and specifies that it is to be calculated according to 'adjusted value'. According to article 3.30, 'adjusted value' is to be calculated in accordance with article 3.3.1. Article 3.3.1 is different to section 159 of the *Customs Act*.

4 Customs Bill EM, p. 36.

2.28 Proposed section 153ZMG provides a list of nine 'operations or processes' that are not sufficient, on their own, to turn a good into a 'Korean originating good'. The list includes, for example, changing packaging, washing and sharpening.

2.29 Proposed section 153ZMG would give full effect, with the appropriate adjustments, to article 3.12 of KAFTA.

*Subdivision F: consignment and outward processing zones*

2.30 According to the simplified outline, 'Subdivision F deals with other matters, such as how the consignment of goods affects whether the goods are Korean originating goods'. It deals with that matter and one other; namely, the question of outward processing zones on the Korean Peninsula.

2.31 Proposed section 153ZMH is designed to allow goods to retain their status as 'Korean originating goods' if they pass through countries other than Korea or Australia, so long as certain conditions are met. It provides that a Korean originating good that is transported through the territory of a country other than Korea and Australia will lose its status as an originating good if it undergoes subsequent production other than processes that are specifically excluded and/or if it does not remain under customs control whilst in the territory of the other country. The processes that would not lead to a loss of status include unloading, reloading and storing.

2.32 Proposed section 153ZMH gives full effect to article 3.14 of KAFTA with the exception that article 3.14 defines 'relabelling' and 'repacking' (two of the excluded processes) quite restrictively<sup>5</sup> and the Customs Bill does not define them at all.

2.33 Proposed section 153ZMI provides that:

Goods are not prevented from being Korean originating goods under this Division if they contain materials that:

- (a) have been exported from Korea; and
- (b) have undergone processing in an area designated as an outward processing zone in accordance with Annex 3-B to Chapter 3 of the Agreement; and
- (c) have been re-imported to Korea after that processing.

2.34 This section is intended to give effect to article 3.13 of KAFTA, which provides that 'certain goods shall be considered to be originating even if they have undergone working or processing outside Korea, on materials exported from Korea and subsequently re-imported there, provided that the working or processing is done in the areas designated by the Parties pursuant to Annex 3-B'. Annex 3-B provides that a committee shall be established to identify possible geographic areas to be so designated. It also provides that 'the Gaesung Industrial Complex located in North

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5 The footnote to article 3.14(2)(a) of KAFTA provides as follows:

For the purposes of this paragraph, "relabelling" means the affixing of labels necessary to meet the requirements of the importing Party; "repacking" means a packing operation necessary to transport the good to the territory of the importing Party.

Korea shall be identified by the committee as one of the geographic areas that may be designated as outward processing zones' [sic].

### ***Verification powers***

2.35 As noted above, section B of Chapter 3 of KAFTA is entitled 'Origin Procedures'. It provides a scheme for certifying originating goods so that such goods are entitled to a tariff reduction. Part 2 of Schedule 1 to the Customs Bill is entitled 'verification powers'. It aims to give domestic effect to two aspects of this scheme (namely the obligation to keep records relating to Certificates of Origin and the obligation to give relevant officers power to require the production thereof) by inserting a new Division 4G into Part VI of the *Customs Act*. As explained in the Customs Bill EM, Certificates of Origin 'are issued by industry groups such as the Australian Chamber of Commerce and Industry and the Australian Industry Group'.<sup>6</sup>

2.36 It should be noted that the provisions of proposed Division 1J (discussed earlier in this chapter) relate to goods being imported into Australia from Korea, while this division applies to goods being exported from Australia to Korea.

### ***Record-keeping***

2.37 Proposed section 126AMB is entitled 'Record keeping obligations' and aims to give effect to article 3.22 of KAFTA. It provides for the making of regulations to impose record-keeping obligations in relation to goods that are exported to Korea and that 'are claimed to be Australian originating goods for the purpose of obtaining a preferential tariff in Korea'. These obligations may be imposed on exporters or producers.

2.38 Proposed sections 126AMC and 126AMD supplement the record-keeping obligations. The former would allow an authorised officer<sup>7</sup> to require the production of such records (as required by article 3.21(1) of KAFTA) and the latter would allow an authorised officer to ask questions to verify the origin of the goods. Both proposed sections allow the authorised officer to disclose the records or answers to a Korean customs official.

### ***Application***

2.39 Part 3 of Schedule 1 to the Customs Bill specifies the goods to which the amendments brought about by the Customs Bill apply.

## **The Tariff Bill**

2.40 The Tariff Bill, if passed, would amend the *Customs Tariff Act 1995* (the Tariff Act) with the aim of implementing some of Australia's commitments under KAFTA, namely:

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6 Customs Bill EM, p. 25.

7 Subsection 4(1) of the *Customs Act* provides, in part, as follows:

*"authorised officer"*, in relation to a section of this Act, means an officer of Customs authorised in writing by the CEO to exercise the powers or perform the functions of an authorised officer under that section.

- providing duty-free access for certain goods and preferential rates of customs duty for other goods that are Korean originating goods;
- phasing these preferential rates to zero by 2021;
- amending Schedule 4 [to the Tariff Act] to maintain customs duty rates for certain Korean originating goods in accordance with the applicable concessional item; and
- creating a new schedule 10 [to the Tariff Act] to specify excise-equivalent duties on certain alcohol, tobacco, and petroleum products and to provide for phasing rates of duty on certain goods as specified in the agreement.<sup>8</sup>

2.41 The amendments to the Tariff Act are contained in Schedule 1 to the Tariff Bill, which contains 32 items. The central item is item 26, which adds a new Schedule 10 to the Tariff Act, which would be entitled 'Korean originating goods'. This item sets out the tariff rates that would apply to particular classes of good. For many of the items in proposed Schedule 10, there are a number of rates that are specified to apply from a certain date (1 January of a specified year). This allows for the decrease of the rate over time.

2.42 As the Tariff Bill EM clarifies, the Tariff Bill aims to implement Annex 2-A of KAFTA.<sup>9</sup> Annex 2-A contains two schedules, one applicable to Australia and the other to Korea.

The Tariff Act contains a number of other schedules that perform a similar function to the proposed Schedule 10. Schedule 5, for example, specifies the rates of duty applicable to 'US originating goods' and Schedule 6 does the same for 'Thai originating goods'. To be given effect, those Schedules are referred to elsewhere in the Tariff Act, most notably section 16, which sets out how the rate of duty is to be calculated and which specifies, for example, that the duty on US originating goods is to be calculated in accordance with Schedule 5. Items 10-12 amend section 16 to make the equivalent provision for Korean originating goods. Item 9 inserts a new section 13G, which defines 'Korean originating goods' by reference to the proposed Division 1J of Part VIII of the *Customs Act* (which is to be inserted by the Customs Bill). Items 1 to 8 and 13 to 18 insert references to the proposed Schedule 10 into other sections of the Tariff Act where appropriate. Items 19 to 25 make amendments to Schedule 4, which provides for concessional rates of duty that apply to certain goods. Items 27 to 31 make amendments to the 'User's guide' to the Tariff Act and item 32 specifies the goods to which the amendments apply.

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8 The Hon Scott Morrison MP, Minister for Immigration and Border Protection, *House of Representatives Hansard*, 4 September 2014, p. 8.

9 Tariff Bill EM, p. 5.