

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 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 signed also 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 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.

- *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.

CASE STUDY: *A company received two almost identical invoices, each intended to cover one half of a shipment. The only difference between the invoices was the invoice number and the order number. The invoices did not state how many packages each covered. The Customs Broker mistakenly took the second invoice to be a copy of the first invoice and used only one invoice to prepare the declaration. Customs detected the error and seized one half of the shipment on the grounds of "non-enumeration". The importer had to make a deposit in the amount of the value of the goods plus the GST in order to obtain delivery. He then applied to the Minister to "waive" the seizure and return the deposit on the grounds that the mistake was obviously innocent. The Minister took several weeks to deliberate on this request but eventually agreed to return part of the deposit only, seizing the remainder as a penalty.*

The invoices should also contain an indication of the terms of trade, e.g. CIF, FOB, etc. When the invoice price includes freight and insurance, it would be most useful if the amounts of freight and insurance included in that price were listed on the invoice.

Some older "Customs Invoice" forms also include information on such things as the cost of internal packaging and the current domestic value. This information is no longer required. Overseas suppliers should be advised to stop producing these special invoices and merely send the printout that comes out of their invoicing application.

Until a few years ago, 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 has now been abolished. Many overseas suppliers still produce certificates of origin for their exports to New Zealand; importers should advise them that they are no longer required.

- **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 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.

Seawaybills, 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.

Airwaybills, 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
-

TARIFFS AND CONCESSIONS

The following is an extract from the New Zealand tariff:

94.03		Other furniture and parts thereof:
9403.10		– Metal furniture of a kind used in offices:
9403.10.01	00L	-- Music and drafting stands
9403.10.09		-- Other

The international structure stops at six-digit level. The number 9403.10 applies to metal office furniture in any of the countries that use this system. In New Zealand, this sub-heading was further sub-divided into 9403.10.01 (music and drafting stands) and 9403.10.09 (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. The residual item was further subdivided into five statistical keys. These are all subject to the same duty rate but were created to enable a more detailed statistical analysis to take place.

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 concessions are listed:

<i>984547L</i>	<i>Locking computer anchor pad protection system</i>
<i>620531D</i>	<i>14 drawer desk top slide filing cabinet</i>

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 the Ministry of Commerce on the grounds that the goods have no locally made equivalents.

- *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 or Fijian 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.

CUSTOMS CLEARANCE

- **Minimum documentation required**
 - **How to ensure that all goods are cleared before arrival**
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MINIMUM DOCUMENTATION REQUIRED

To clear goods through Customs in New Zealand, you *need* a commercial invoice and a copy of the bill of lading or airwaybill, *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) has been abolished. 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 EDI message. New Zealand Customs are unable to receive EDI messages for invoices and waybills, at present. There is therefore a need for the recipient of these electronic documents to be able to produce a hard copy printout of the information for production to Customs, should it be required.

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 electronic mail message received directly from the overseas supplier or freight forwarder.

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

HOW TO ENSURE THAT ALL GOODS ARE CLEARED BEFORE ARRIVAL

New Zealand Customs will accept declarations lodged up to five days before the arrival of a ship or one day before the arrival of an aircraft. This means that it is possible to have the goods cleared before they arrive. To achieve this for the majority of consignments should be a primary objective of every shipping manager.

In order to achieve this objective, shipping managers should implement systems that enable the information to arrive well in advance of the goods. Such systems can be as complex as a full EDI implementation or as simple as demanding that the invoice and the document of transport be faxed. The following is a typical example of how this can be achieved:

CASE STUDY: THE PROBLEM: *A company regularly sent several containers from their factory in Brisbane to their associated company in Auckland. The Bill of Lading was normally issued by the shipping company on the day that the ship left Brisbane. This was then posted back to the exporter, who printed the commercial invoices and sent that documentation by international courier to their associated company's head office in Wellington. The Wellington Company then sent the documentation by courier to their Customs broker, who prepared and lodged an entry with Customs in Auckland. The original bill of lading was then presented to the Auckland office of the shipping company where it was swapped for a delivery order. Customs would produce also a delivery order within one to two days of lodgement of the entry. The ship took four days to arrive in Auckland from Brisbane. Frequently, the paper trail took longer and it was not uncommon for the importer to be charged demurrage.*

THE SOLUTION: *The Brisbane Company instructed the shipping company to issue "express release bills of lading". These documents enabled the importer to obtain release from the shipping company on a fax, i.e. there was no longer any need to wait for the original bill of lading. The Broker installed a piece of software in the exporter's PC, which enabled for the automatic transmission to his computer of an EDI message containing all the necessary information. All containers became routinely available as soon as they were discharged from the ship and demurrage charges stopped.*

Importers need to impress upon their suppliers the importance of receiving the necessary information by email or fax. The most effective way is to ensure that all your letters of credit have a clause as follows:

"Beneficiary's statement certifying that a copy of the commercial invoice and bill of lading have been emailed or faxed to the applicant within three days of bill of lading date."

The net result of this is that the exporter is required to give a statement to his bank as above, before he can get paid for the shipment. This does not, of course, ensure that he complies but it acts as a good reminder. All you have to do is instruct your bank *in writing* to ensure that they automatically insert this clause into all your future letters of credit. If you do not use letters of credit, make sure that a similar clause is printed or rubber-stamped on your overseas purchase order forms. In the case of airfreight, you should request the supplier to send you a fax or an e-mail message as soon as the flight is booked, containing the following information:

- **Flight number and date. House airwaybill number. Number of packages. Gross weight**

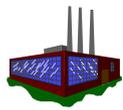
You should also have on file information on freight rates and whether the freight is prepaid or collect. If your supplier is unable to comply with this request, you should have no difficulty in finding a freight forwarder who will undertake to fax this information to you as soon as the booking is received from the supplier.

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- *Goods can and should be cleared before arrival*
 - *Use conditions on L/Cs and purchase orders to obtain faxes*
 - *Ask forwarders to produce advanced notification by fax*
 - *Consider using EDI or e-mail. Examine need for formal B/L*

TERMS

 Exporter pays

 Importer pays



EXPORTER

CARRIER

SHIPPING Co

CARRIER

IMPORTER

EXW — Ex Works



Importer bears all costs of transportation from Exporter's premises.

FOB — Free on Board



Exporter responsible for costs up to "on board" ship or aircraft. Importer pays freight.

CFR — Cost and Freight and CIF — Cost, Insurance and Freight



Exporter responsible to bring goods to named destination. Exporter pays freight.

DDP and DDU — Delivered Duty (Paid or Unpaid) — Also known as FIS — Free Into Store



Exporter is responsible for all costs until delivery into Importer's premises.