

December 24, 2010

To: Mr. XXX
General Director
XXXXXXXXX LLC

Dear Mr. XXX,

Please find below our comment concerning customs classification processor units in Russia. The comment covers the following issues:

1. Description of current alternatives for classification of processor units including technical issues, classification approaches applied in foreign countries and the possibility to use such approaches in Russia.
2. The analysis of classification of processor units of the following models: XXXXXXXXX (hereinafter – processor units) based on technical information available on official site: www.xxxxxxxxxxxxxxx.com
3. The estimation of risks which a Russian importer runs in case of incorrect classification of processors units as well as risks which exporter may run if the customs authority reveals the incorrect classification (based on the documents provided to us).

It should be noted that at present time (since 1 January 2010) Russia applies the Unified Goods Nomenclature for Foreign Economic Activity of the Customs Union (hereinafter – the Nomenclature) according to the Decision of the Customs Union Commission of 27 November 2009 № 130. Based on the Nomenclature the processor units can be classified under one of the following classification codes inter alia:

- 1) 8541 31 1000 - multiple-chip integrated circuits (in Russian: «многокристалльные интегральные схемы»), import customs duty rate is 3.5%.
- 2) 8542 31 9001 - monolithic integrated circuits (in Russian: «монокристалльные интегральные схемы»), import customs duty rate is 0%.

Based on our analysis it should be concluded that the application of one of the codes above depends on physical characteristics of the processor. The most important criterion in this case is the number of chips or dies (i.e. pieces of semiconductors or semiconductor materials which are included in the circuit). In particular, multi-core processors can be classified either as multi-chip integrated circuits or as monolithic ones. This statement can be confirmed by unofficial internet sources (e.g. <http://www.osp.ru/pcworld/2007/03/4178436/>).

As concerns classification of processor units it should be noted that according to our research these processor units are not homogeneous and thus, it would be unreasonable to classify all

of them under a single classification code. According to the official information taken from Client web-site one may presume that certain processors may be regarded as monolithic integrated circuits. Such a presumption is based on the following statement: “multi-core processors are single chips that contain two or more distinct processors or execution cores in the same integrated circuit.”

Based on the analysis of the above pages it is possible to make a conclusion that the above statement should be referred to processor units in question. Nevertheless, there is no any clear indications for this. In other words, there is no a statement that would stipulate clearly that processor units are single chips consisting of the single integrated circuit”. For this reason we suppose that there may be certain difficulties in proving the monolithic nature of the above processor units to customs authorities by using this argument.

Moreover, there are certain types of processors, which may be regarded as multiple-chip integrated circuits based on the official information taken from Client web-site as well as information from unofficial internet sources. As concerns official information at least the following types of processor units can be classified as multiple-chip integrated circuits:

- 1) XXXX
- 2) YYYY

In particular, in the datasheet for XXXX processor there is information about “second die”. Based on the analysis of this information one may conclude that such processors contain more than one chip (i.e. die or circuit). Moreover, such conclusion is confirmed by a significant number of unofficial sources.

As concerns YYYY processors which are based on Westmere 32 nm technology, there are exact indications that such processors are considered as a part of multiple-chip modules (i.e. multiple-chip integrated circuits).

We suppose that if the customs authorities reveal this information, they may use it in order to prove that the above processors should be regarded as multiple-chip integrated circuits. For this reason, if the importer intends to classify such processors as monolithic integrated circuits (classification code 8542 31 9001), it should provide customs authorities with technical documentation issued by the producer and stipulating clearly that the above products consist of only one chip. It is also recommended to produce such documents in respect of all other processors which are imported into Russia in order to avoid problems during customs clearance. Nevertheless, even if the importer submits the above documents to the customs authority, the latter may hold a technical expertise (in particular, during the customs clearance process) in order to identify the physical characteristics of the processors. In case customs authority reveals that actual characteristics do not correspond to the information in the above documents, it will impose additional customs payments, penalty interests and fines (for more detailed information please see below) on the importer or a customs representative (i.e. broker) if it is the broker who has signed the customs declaration and submitted the above documents. The customs authority does not impose any duties, fines and penalty interests on the producer even if it is the producer who issues the above documents.

In addition to the above we also held the analysis of European and USA goods nomenclatures. According to European Community’s integrated tariff (TARIC) processors can be classified as multiple-chip integrated circuits or monolithic integrated circuits. Meanwhile, zero customs duty rate applies for both cases above. According to Harmonized Tariff Schedule of the USA processor units are classified under one single classification code (8542 31 0000) irrespective of that whether they are of monolithic or multiple-chip nature. Zero

customs duty rate also apply to this code. There are not any available examples (e.g. binding classification decisions) of classification of the Client processor units. Also, there is no any court practice on this issue. As a result, it may be concluded that neither Russian importers of Client processors, nor customs authorities will be able to use these resources (i.e. foreign classification practice and court practice) in order to assert their position in a court or in other similar situation.

It should be noted that if customs authority reveals that classification code of the imported goods (e.g. processor units) has been declared incorrectly, it is supposed to correct the code. In this case the importer runs the following risks:

- 1) Additional customs duties;
- 2) Penalty interests for late payment;
- 3) Administrative fines.

In case the customs authority brings a decision to change the declared classification code it is supposed to recharge customs duties according to the new code. In particular, as concerns processor units, if the customs authority decides to apply the code 8541 31 1000 (multiple-chip integrated circuits) instead of 8542 31 9001 (monolithic integrated circuits), the customs duty rate will increase from 0% to 3.5% of the customs value of the processor units imported. As a result a significant amount of customs duties will be charged to the importer in this case. The amount of import VAT will also increase in this case because it is calculated based on the total sum of the customs value and the customs duty.

Moreover, if the customs authority reveals incorrect classification within the customs audit held after release of goods (i.e. when the customs clearance is finished), it will also charge penalty interest arising from the failure to meet the payment deadline (i.e. to pay all customs duties due at the date of submitting the customs declaration). The penalty interest shall be charged for every calendar day of the delay in paying at the refinancing rate of the Central Bank of Russia, starting from the day when the goods were released.

In addition, if the customs authority reveals (either before or after release of goods) that apart from incorrect classification codes, the importer has also submitted the incorrect description of goods to the customs authority (e.g. in case multiple-chip processor units are described as monolithic integrated circuits), the customs authority may consider such a situation to be a violation of customs rules, i.e. incorrect declaration of goods. The fine for such a violation varies from 50 to 200% of the amount of unpaid customs duties and taxes. Moreover, the improperly declared goods can be seized by customs authorities apart from imposing a fine. As it was mentioned above, the fines may be also imposed on a customs representative (broker) if it is the broker who has signed the customs declaration. It should be mentioned that such administrative measures may have quite a negative impact on the activity of the broker. The point is that its brokerage license may be revoked on that ground and the broker will not be able to render brokerage services for a certain period of time. As a result, the broker may decide to sue the importer so that the importer pays for the damage incurred by the broker (because it is the importer who provides the broker with the documents which it submits to customs authorities).

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We trust that the above information is useful to you. If you have any questions regarding the above or require assistance in any other matter, please do not hesitate to contact us.

Yours sincerely,

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