

# Navigating Trade Agreements: Legal Considerations for your Business Customs Compliance

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# Today's Presenters

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# Understanding Free Trade Agreements (FTAs)

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# Understanding FTAs

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## Introduction

- What is a free trade agreement (“FTA”)?
  - An agreement between two or more countries where each country agrees to certain obligations that affect trade and certain protections for investors and rights.
- Why is it important to understand FTAs?
  - Discover opportunities for duty-savings
  - Confirm duty-savings are supportable
- How to know whether your products are eligible?
  - Understanding rules and applying a fact-specific and rule-specific analysis

# Understanding FTAs

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## Rules of Origin

- Wholly obtained or produced
  - E.g., goods that are grown, harvested, mined, hunted, trapped, fished, etc.
- Goods Produced Exclusively from Originating Materials
  - E.g., non-originating wood shipped into an FTA territory and transformed into a skateboard frame – making the skateboard frame into an originating material, used with other originating materials to produce a finished skateboard
- Goods Produced Using Non-originating Materials Satisfying an Applicable...
  - Change in Tariff Classification Requirement; or
  - Regional Value Content Requirement

# Understanding FTAs

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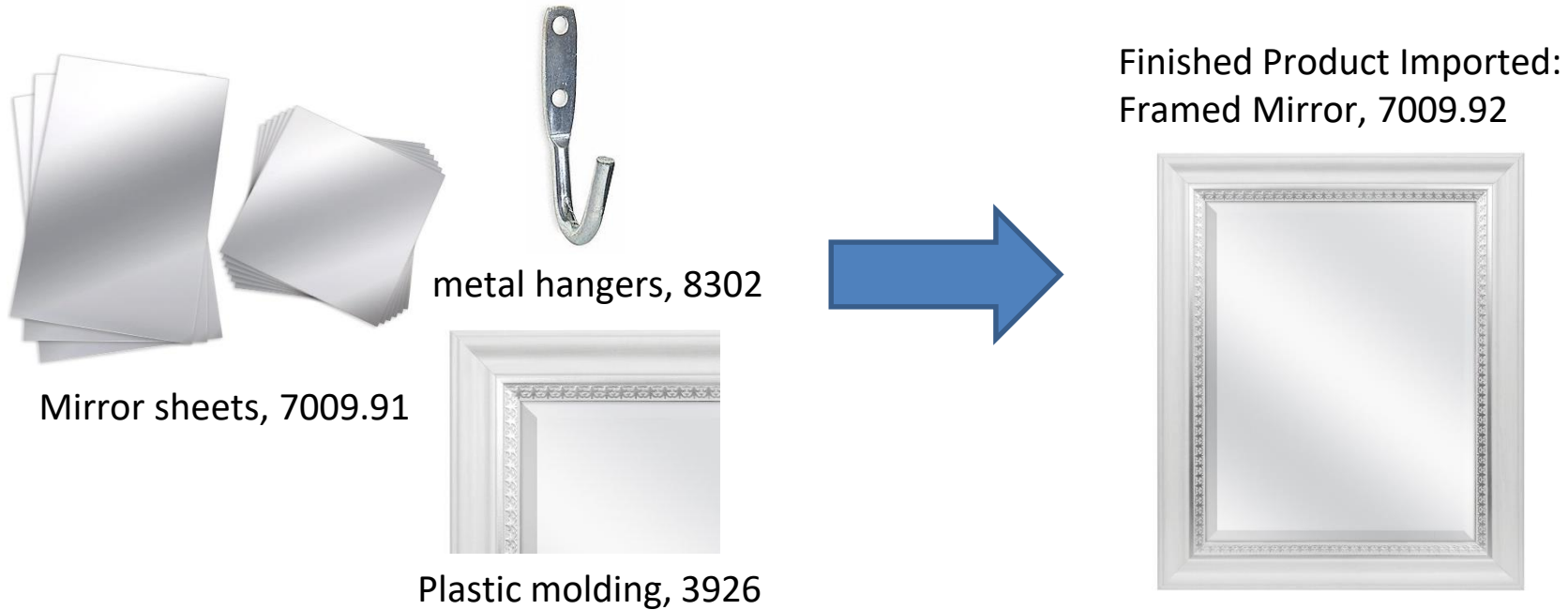
## Rules of Origin – Change in Tariff Classification Requirement

- What is a tariff shift?
  - A rule of origin involving a change in tariff classification (i.e. a “tariff shift”) requires each non-originating material (or part) used in the production of a good to undergo a change in HTS classification as a result of some process occurring in the FTA Party territory.
- USMCA Example
  - Framed mirrors of 7009.92.50, HTSUS
  - Non-originating materials (mirror sheets of 7009.91, plastic molding of 3926.30, metal hangers of 8302.41)
  - GN 11(o)/70.8: “A change to subheading 7009.92 from any other subheading”

# Understanding FTAs

Rules of Origin – Change in Tariff Classification Requirement

*GN 11(o)/70.8: “A change to subheading 7009.92 from any other subheading”*



# Understanding FTAs

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## Rules of Origin – Regional Value Content Requirement

- What is an RVC requirement?
  - Rule of origin requiring that a good include a certain percentage of FTA content. To benefit, the product must have added value from an FTA Party.
- Example: USMCA RVC Formulas
  - Transaction Value Method
$$\text{RVC} = ((\text{TV} - \text{VNM}) / \text{TV}) \times 100$$
    - ✓ *Transaction value of the good excluding any costs incurred in international shipment*
    - ✓ *VNM = Value of non-originating materials, including materials of undetermined origin*
  - Net Cost Method
$$\text{RVC} = ((\text{NC} - \text{VNM}) / \text{NC}) \times 100$$
    - ✓ *NC = Net cost of the good*
    - ✓ *VNM = Value of non-originating materials, including materials of undetermined origin*



# Understanding FTAs

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## Rules of Origin (Other, USMCA)

- Other Common FTA Rules
  - De minimis
  - Direct shipment/Transshipment
  - Treatment of accessories, spare parts, packaging materials, containers, etc.
- Other Rules (USMCA)
  - Unassembled goods and goods classified in the same HTS code as their parts
  - Inventory management methods
  - Self-produced material rule

# USMCA Case Study: ROOs in Practice

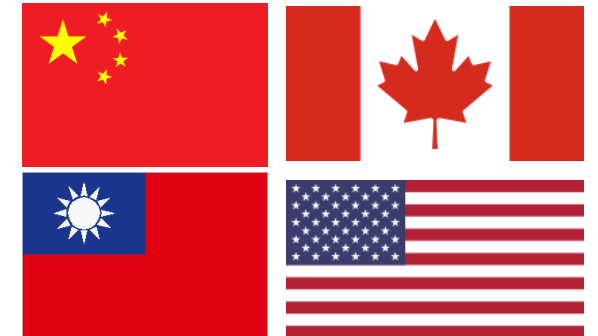
## Example Fact Pattern

*The imported goods are foam mattresses with quilted covers. Manufacturing operations include: In China, mattress covers are made of rayon/polyester blend fabric. The mattress covers are shipped to Canada. In Canada, the mattress foam is made and further manufactured into the mattress core. The China-origin mattress cover is stuffed with the Canada-origin mattress foam core. The completed mattress is then compressed and boxed with retail packaging materials and shipped to the United States for retail sale. The bill of materials (BOM) confirms that all materials originate from the United States, but for polyol stable DP1022 (from Taiwan), amine A-33 (from China), and the mattress cover (from China). The finished mattresses enter the United States under subheading 9404.21.00, HTSUS, which carries a 3% ad valorem duty rate.*

Imported Finished Good



Raw Materials



# USMCA Case Study: ROOs in Practice (Example)

## USMCA, General Note 11 (b): Rules of Origin

- (b) For the purposes of this note, a good imported into the customs territory of the United States from the territory of a USMCA country, as defined in subdivision (l) of this note, is eligible for the preferential tariff treatment provided for in the applicable subheading and quantitative limitations set forth in the tariff schedule as a "good originating in the territory of a USMCA country" only if—
- (i) the good is a good wholly obtained or produced entirely in the territory of one or more USMCA countries;
  - (ii) the good is a good produced entirely in the territory of one or more USMCA countries, exclusively from originating materials;
  - (iii) the good is a good produced entirely in the territory of one or more USMCA countries using nonoriginating materials, if the good satisfies all applicable requirements set forth in this note (including the provisions of subdivision (o)); or
  - (iv) except for a good provided for in any of chapters 61 through 63—
    - (A) the good is produced entirely in the territory of one or more USMCA countries;
    - (B) one or more of the nonoriginating materials provided for as parts under the tariff schedule and used in the production of the good do not satisfy the requirements set forth in this note because—
      - (1) both the good and its materials are classified under the same subheading or under the same heading that is not further subdivided into subheadings; or
      - (2) the good was imported into the territory of a USMCA country in unassembled form or disassembled form but was classified as an assembled good pursuant to general rule of interpretation 2(a) of the tariff schedule, and
    - (C) the regional value content of the good, determined in accordance with subdivision (c) of this note, is not less than 60 percent if the transaction value method is used, or not less than 50 percent if the net cost method is used,
- and such good satisfies all other applicable provisions of this note.

For purposes of determining whether a remanufactured good is an originating good, a recovered material derived in the territory of one or more USMCA countries shall be treated as originating if the recovered material is used or consumed in the production of, and incorporated in, the remanufactured good.

# USMCA Case Study: ROOs in Practice (Example)

## USMCA, General Note 11 (o)/94.6

### Chapter 94

**Chapter rule 1:** For the purposes of the subdivisions pertaining to this chapter, whenever the subdivision designation is underscored, the provisions of subdivision (k) of this note may apply to goods for use in a motor vehicle of chapter 87.

**Subheading rule:** The underscoring of the designations in subdivision 1 pertain to goods provided for in subheadings 9401.10 through 9401.80 for use in a motor vehicle of chapter 87.

1. (A) A change to subheadings 9401.10 through 9401.80 from any other chapter; or  
(B) A change to subheadings 9401.10 through 9401.80 from subheading 9401.90, whether or not there is also a change from any other chapter, provided there is a regional value content of not less than:
  - (1) 60 percent where the transaction value method is used; or
  - (2) 50 percent where the net cost method is used.
2. A change to subheading 9401.90 from any other heading.
3. A change to subheadings 9402.10 through 9402.90 from any other subheading, including another subheading within that group.
4. (A) A change to subheadings 9403.10 through 9403.89 from any other chapter; or  
(B) A change to subheadings 9403.10 through 9403.89 from subheading 9403.90, whether or not there is also a change from any other chapter, provided there is a regional value content of not less than:
  - (1) 60 percent where the transaction value method is used; or
  - (2) 50 percent where the net cost method is used.
5. A change to subheading 9403.90 from any other heading.
6. A change to subheadings 9404.10 through 9404.30 from any other chapter.
7. A change to subheading 9404.90 from any other chapter, except from headings 5007, 5111 through 5113, 5208 through 5212, 5310 through 5311, 5407 through 5408 or 5512 through 5516.
8. A change to subheadings 9405.10 through 9405.40 from any subheading outside that group.

# USMCA Case Study: ROOs in Practice (Example)

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## Fact Pattern Example – *De minimis*

6. A change to subheadings 9404.10 through 9404.30 from any other chapter.

- BOM non-originating materials
  - Polyol Stable DP1022 (Taiwan) – 2905.39, HTSUS – **Originating per GN 11 (o)/94.6**
  - Amine A-33 (China) – 3815.90, HTSUS – **Originating per GN 11 (o)/94.6**
  - Mattress Cover (China) – 9404.90, HTSUS – **Not originating per GN 11 (o)/94.6**

# USMCA Case Study: ROOs in Practice (Example)

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## Fact Pattern Example – *De minimis*

(e) De minimis amounts of nonoriginating materials.

(i) In general.—Except as provided in subparagraphs (e)(ii) through (iv) below, a good that does not undergo a change in tariff classification or satisfy a regional value content requirement set forth in subdivision (o) of this note is an originating good if—

(A) the value of all nonoriginating materials that are used in the production of the good, and do not undergo the applicable change in tariff classification set forth in subdivision (o) of this note—

(1) does not exceed 10 percent of the transaction value of the good, adjusted to exclude any costs incurred in the international shipment of the good; or

(2) does not exceed 10 percent of the total cost of the good;

(B) the good meets all other applicable requirements of this note; and

(C) the value of such nonoriginating materials is included in the value of nonoriginating materials for any applicable regional value content requirement for the good.

- BOM non-originating materials

- Mattress Cover (China) – 9404.90, HTSUS – **Originating per GN 11(e)(i)(A)(1)**

# Free Trade Agreements – Compliance

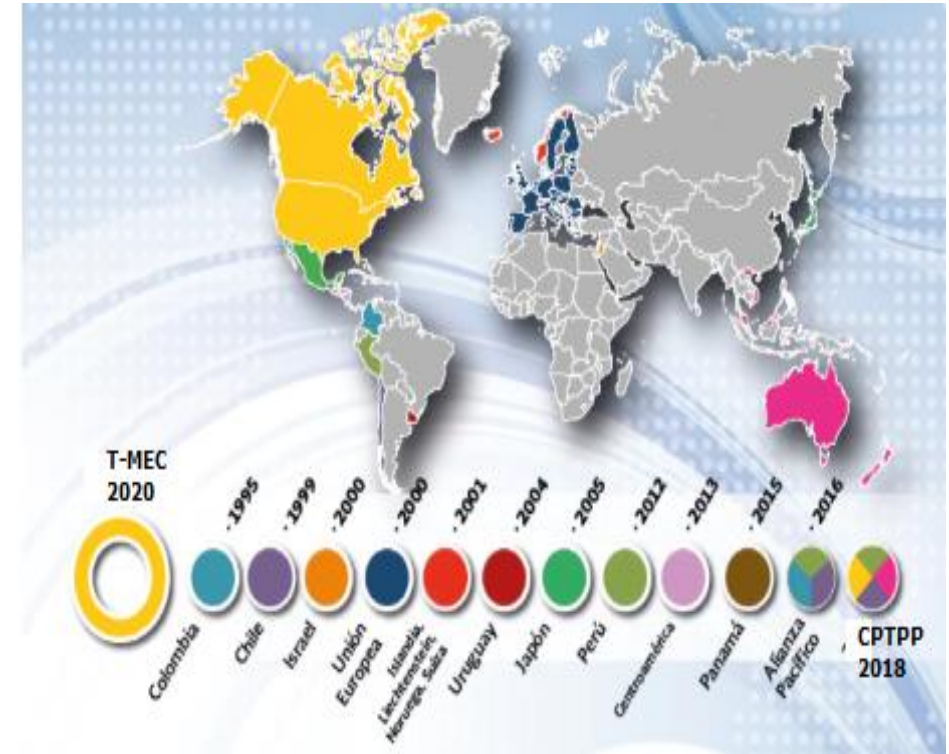
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# Competitiveness with compliance

- Since the past three decades, Mexico has promoted the international trade of goods
  - 16 Free trade agreements with more than 40 Countries.
  - CPTPP
  - TLCUEM
  - Latin-American Agreements





# Competitiveness with compliance

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- Free Trade Agreements commitments and local implementation
- Trade facilitation benefits for producers, exporters, importers
- Preferential tariff rates
- Strengthening of the supply chain
- Obligations arising from the business cross border structure
- Increase auditing activity in Mexico in origin verifications through different sectors



# Origin verification - Preferential tariff treatment

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- **Producer and Exporter's obligations**

- Verification of compliance with the rule of origin
- Correct issuance of a certificate of origin (proper filling of format)
- Preservation of origin certification file, including all the documentation that demonstrates the goods' manufacture traceability
- Bill of materials
  - ✓ HTS classification of raw materials and inputs
  - ✓ Country of origin of secondary materials
  - ✓ Certificates of origin or affidavits issued by the producers of secondary materials
  - ✓ Value/cost of the secondary materials

# Mexican origin verifications procedures

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- **SAT - Origin Verifications**

- Under USMCA, authorities at the importer's country can perform audit procedures against the exporters or producers.
- They can either be triggered through a questionnaire notified at the exporter/producer facilities, or through a verification visit from the foreign authorities.
- Specific deadlines (30 days) need to be considered, therefore it is imperative to begin attending this procedure immediately.
- Potential consequences: invalidation of certificates of origin and the importer will be subject to important tax contingencies.
- Potential legal actions from the importers against exporters or producers at their respective countries.

# Mexican origin verifications procedures

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- **Origin Verifications' recommendation to your business**
  - Exporters should be in permanent contact with the producers of the goods, with the sufficient product's traceability evidence and keep the records at least 5 years.
  - Importers must conduct preventive audits to the producers and the exporters, to verify on permanent basis the compliance of specific rules of origin.
  - Producers should periodically update the Bill of Materials of the originating goods.
  - Have supply contracts that establish responsibilities for improperly certifying the origin of goods. The responsibilities of all Parties must be included in your agreements.

# Mexican origin verifications procedures

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- **Importers obligations**

- Preservation of all certificates of origin, as well as the origin documentation, thus in 3 years they will be able to certify such origin.
- Prior to import, verify the correct tariff classification of the merchandise and the specific rule of origin.
- Defense files structure and elaboration.



# Current customs audits elements and focus

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- **For permanent imports, these are the most relevant matters that could be audited:**
  - Customs value, in accordance with the new value manifests, inclusion of restrictive requirements to be imported, such as: payments, royalty agreements, supply agreements, etc.
  - Correct tariff classification (additional two digits “NICO”)
  - Compliance with non-tariff regulations (import permits, Mexican official standards, labeling)
  - Estimated prices for sensitive products such as textiles, apparel, shoe wear, steel, aluminum products, etc.
  - Insurance, freights expenses and royalties

# Current customs audits elements and focus

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- **Temporary import regime, through IMMEX programs**
  - The compliance with the specific temporality determined by law, 18 or 12 months
  - Annex 24 compliance (inventory control system)
  - Issuance of complementary “pedimentos” (USMCA article 2.5)
  - Compliance with non-tariff regulations (import permits, Mexican official standards)
  - VAT Certification compliance
  - Annex 31 / VAT credits

# Free Trade Agreements – Business Implications & Legal Risks

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# Business Implications & Legal Risks

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## 1. Business Issues Arising from Trade Agreements

- Understand how risk is borne between the parties
- Incoterms in contracts address specific responsibilities in international transactions. They define:
  - Risk: who is responsible for risk of loss or damage and associated costs at various points in delivery?
  - Responsibilities: who is responsible for packing, international transport costs, import and export clearance including duties, and delivery?
  - \*Incoterms do not address transfer of title.
- Who bears the risk of increased costs arising from unexpected tariffs?
  - Consider termination & renegotiation rights and impact on tariff risks.

# Business Implications & Legal Risks

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## 2. The Importer's Liability and Implications

- The Importer of Record normally has liability for duties/tax on import as well as other compliance obligations (e.g. import permits, product certifications, licenses)
- Risk can be transferred contractually, but ultimately the customs authorities will impose liability on the Importer
- Customs brokers, freight forwarders and other agents will disclaim liability
- As Importer of Record:
  - Are you confident in relying on classifications provided by the supplier?
  - Would you be able to secure the documentation you need from the supplier to substantiate a “rules of origin” (free trade agreement) analysis?
  - Can you transfer risk to suppliers?
- \*\* When procuring commodities at high risk for tariffs, consider diversifying sources of supply to be less dependent on a single jurisdiction.

# Business Implications & Legal Risks

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## 3. The Exporter's/Producer's Liability and Implications

- Exporters & producers who provide a certification of origin under free trade agreements have regulatory compliance responsibilities
- Customs laws require retention of certifications and all supporting documentation:
  - Contract for sale, records of purchase of all direct and indirect materials used in production, records of production for the good in issue
- Customs authorities in the importer's country may conduct verifications of exporters & producers
- If the importer incurs liability as a result, they can take action against the exporter or producer, including civil suits to recover losses

# Business Implications & Legal Risks

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## 4. Customs Audits and Trends

- Audit activities delayed for COVID have resumed
- Common errors include:
  - Misclassification of goods; especially acute for regulated commodities (agriculture & food products, textiles)
  - Claim free trade tariff treatment without the ability to substantiate
  - Using the wrong sales price as the value for duty, e.g.
    - ✓ Foreign sales price to the U.S. instead of U.S. intercompany price to Canada

# Business Implications & Legal Risks

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## 5. Trade Checklists

- ☐ Do you understand the current exposure to customs and trade non-compliance risks?
  - ❖ To what extent could these increase post-NAFTA/USMCA?
- ☐ Have you reviewed Incoterms and the current liability for import/export costs and compliance?
- ☐ Is there a current customs and trade compliance manual or framework? If so, does it need updating?
- ☐ Who in the business is responsible for customs and trade compliance? Is there a clear escalation policy in the event of an audit or investigation?
- ☐ Reviewing contracts with customs agents and 3PLs. Can they be amended to share the risk of poor data entry on customs declarations?
- ☐ Does the business understand the core data requirements for a customs declaration and the legal risks associated with getting this wrong?

# Business Implications & Legal Risks

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## USMCA

- ☐ Are there changes to product-specific rules of origin that must be reviewed?
- ☐ Have greater regional-value-content or other flexibilities been explored?
- ☐ Is it possible to make use of direct-to-consumer courier shipment de minimis rules to avoid duties/tax on entries into Canada/Mexico?
- ☐ Conversely, are there ways to leverage U.S. de minimis rules to avoid Chinese and other third-country tariffs?

# Questions?

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