Surviving the U.S.-China Trade Wars

Strategies to mitigate import duties

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Views expressed are those of the presenters

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5. Duty Drawback Strategies
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Importing Foreign Products

Importing Foreign Products

- Companies must always answer three questions when they import products:
  - **What is the product?**
    - Classify products under the Harmonized Tariff System of the United States. Other countries have similar tariff codes.
  - **Where did it come from?**
    - Country of Origin is the product's "nationality." This can vary depending on where the product was made, how it was made, and whether a Free Trade Agreement applies.
  - **How much is it worth?**
    - The value should generally be the arms-length fair market value of a product.
- The answers to these questions determine *whether* tariffs apply, and *how high* those tariffs might be.
  - The same questions can also trigger higher tariffs on certain Chinese goods.

Section 301 Tariffs

Section 301 Tariffs

- Section 301 of the Trade Act allows the U.S. Government to impose additional tariffs on products from countries engaged in unfair trading practices.
  - Section 301 tariffs are both country-specific and product-specific.
    - Different tariff rates can apply to different products.
    - Don’t assume that one size fits all.
  - These tariffs are imposed *in addition to* other tariffs on the same goods.
    - Normal tariff rates.
    - Anti-dumping duties.
    - Countervailing duties.
    - Section 232 tariffs.
  - Failure to pay Section 301 tariffs on targeted products from targeted companies is called “circumvention” and can lead to civil and criminal penalties.

Section 301 Tariffs

- The U.S. Government currently imposes Section 301 tariffs on four broad categories of Chinese-origin products.
  - List 1 – July 6, 2018
    - 25 percent tariff rate on $34 billion in Chinese-origin products.
  - List 2 – August 23, 2018
    - 25 percent tariff rate on $16 billion in Chinese-origin products.
  - List 3 – September 24, 2018
    - 10 percent tariff rate on $200 billion in Chinese-origin products.
    - Rate could increase to 25 percent if the current U.S.-China trade talks break down.
  - List 4 – TBD
    - Proposed 25 percent tariff rate on $267 billion in Chinese-origin products.
    - Tariffs are pending based on the outcome of U.S.-China trade talks.

Alternative Sourcing

Alternative Sourcing

What It Is.

- Source products subject to Section 301 tariffs from suppliers in countries outside China.
  - India
  - Indonesia
  - Malaysia
  - Taiwan
  - Vietnam

How It Works.

- Section 301 tariffs on Chinese products only apply to products with a Chinese Country of Origin.
- As long as products are "wholly produced" or "substantially transformed" in other countries, the Section 301 tariffs do not apply

Practical Advice.

- Approach current suppliers about dual or shift in manufacturing.
- Move final, complex assembly/processing to third country.
- Disaggregation
- Watch for third country activity that doesn't result in change to origin (*more on this later*).

Alternative sourcing is the clearest way to eliminate Section 301 tariffs, but requires re-designing your global supply chains

Exclusion Requests

Exclusion Requests

What It Is.

- Special process to "exclude" products from the scope of the Section 301 tariffs.
- Companies must meet criteria set by the U.S. Trade Representative ("USTR").
- Economic harm is not enough to qualify.

How It Works.

- Companies must apply for exclusions in order to qualify for them.
- Products must be described in a manner that makes it easy to for CBP to identify them when they are imported.
- Exclusions are only temporary (1 year).

Practical Advice.

- Long approval process with high denial rates.
- If/when List 3 exclusions allowed: Establish cross-functional team, evaluate highest impact items first.
- No harm in filing, but have realistic expectations based on your situation.
- Benefiting from others' granted exclusions.

The Exclusion Request filing deadline for List 1 and List 2 items have passed. There is currently no Exclusion Request process for List 3.

Duty Drawback Strategies

Duty Drawback Strategies

What It Is.

- Allows companies to get a 99 percent “discount” on tariffs they already paid on imported goods.
- Program is designed to support U.S.-based manufacturers that export products outside the United States.

How It Works.

- Imported goods must be used to manufacture products in the United States, and then exported to other countries.
- Imported goods that are damaged, destroyed, or lost can also qualify for duty drawback.

Practical Advice.

- Complex commercial program, requires matching imports and exports.
- Systems-based processing recommended.
- Time limitations, documents and recordkeeping.
- Specialized third party providers.

Duty Drawback can reduce tariff burdens, but requires careful import and production cost accounting systems

Bonded Warehouses

Bonded Warehouses

What It Is.

- Allows companies to import and store goods in the United States on a “duty free” basis.
- Program helps companies ship and warehouse goods in transit through the United States without the need to pay tariffs.

How It Works.

- Dutiable merchandize can be stored, manipulated, or undergo manufacturing without duty payment.
- Can remain for 5 years, duty only paid when withdrawn for consumption.
- No duty paid if merchandise subsequently exported.

Practical Advice.

- Bonded warehouses fairly common/available.
- Entry and bond required at time of import.
- Consolidating withdrawals to reduce expense.
- Manufacturing limitations.
- FTZ is a similar concept, with some important differences.

Bonded Warehouses and FTZs can maintain the global supply chain networks by using the United States as a ”duty free” distribution hub.

Circumvention Risks

Section 301 Tariffs

- Failure to pay Section 301 tariffs on targeted products from targeted companies is called “circumvention” and can lead to civil and criminal penalties.
  - Circumvention can arise in several instances:
    - Suppliers route Chinese-origin products through third countries and falsify the import records to hide the actual Country of Origin.
    - Suppliers use Chinese-origin inputs to manufacture products in other countries, but the manufacturing is not “substantial” enough to change the Country of Origin.
    - Suppliers use Chinese-origin inputs to manufacture products in countries that have Free Trade Agreements with the United States, but don’t meet the agreement’s requirements.
- Preventing circumvention is a top CBP enforcement priority.
  - Know your suppliers, their sourcing strategies, and their manufacturing.
  - Verify that the supplier’s information is truthful and accurate.
  - Accurate recordkeeping is crucial.

Conclusions

Survival Strategies

- **Don’t depend on a political solution.**
  - Although press reports suggest a deal is pending, there is no way to know whether this will occur or what shape the deal might take.
  - Press reports indicate that some of the U.S. tariffs on Chinese goods may be “normalized” as part of a negotiated settlement.
  - Congress remains reluctant to challenge White House policy on China tariffs, and industry associations have less influence than in the past.
  - New tariffs and trade tensions with China could arise at any time – especially with the 2020 Presidential Election coming.
  - Companies that plan and adapt now will be in the best position to save costs and protect supply chains later.

Survival Strategies

- Seven Steps for Surviving the U.S.-China Trade War
  - Step 1 – Identify all Chinese products subject to the Section 301 tariffs.
  - Step 2 – Explore alternative sources from other countries.
  - Step 3 – File Exclusion Requests (if eligible).
  - Step 4 – Offset increase tariffs through Duty Drawback whenever possible.
  - Step 5 – Use bonded warehouses to avoid duties on goods in transit.
  - Step 6 – Validate the Country of Origin for incoming products.
  - Step 7 – Keep clear and complete records of everything.

Thank you

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