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Tariffs & Tea Leaves

A Survivor's Guide

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Do you feel like it's a jungle out there? With a new day, there arrives a new tweet and a new tariff.

You may have lots of questions:

- Are we still trading with Mexico and Canada? Mexico or Canada?
- What is a tranche and how are Chinese imports affected?
- Who's retaliating against whom?
- Which list are ***you*** on?

Here are a few strategies to help companies mitigate the financial impacts posed by tariffs in this ever-shifting trade landscape. These mitigation methods are not 'silver bullets' or nefarious work arounds, but compliant techniques that leverage existing trade laws, policies, and programs.

> These Survival Guide techniques may require analysis of existing supply chain activities, research of various resources, and, in some cases, consultation from outside experts. These are long-term solutions that will improve the overall health of your import program, so it's worthwhile to invest the time and effort required to get it right.

Every day, we hear from importers wondering how to hack their way through the tariff trenches (and tranches) and keep their companies safe and profitable in the process. The following scenarios are inspired by true stories. Names, products, and places have been changed to protect the savvy.

Survival Scenario #1: Born in the USA

Situation: ABC Company has been importing widgets under HTS#DutyFree from China for 40 years. Now, they're being told their widgets are in Tranche No. 3. Unsure of what Tranche 3 is, or what it means for their imports, ABC Co. asked the following questions:

Q: What the heck is a Tranche, anyway?
A: In this instance, Tranche No. 3 is a list of goods imported from China subject to Section 301 tariffs. To determine if ABC Co. is subject to these tariffs, additional information is needed.

Q: Are all the components in ABC Co.'s widget from China?
A: All components come from China with the exception of Component Q.

Q: Where does Component Q come from?
A: This component comes from Alabama.

Q: Does Component Q undergo more than simple assembly in China?
A: Component Q is an arm and is screwed onto the widget just before being packaged for shipping all over the world.

Q: What percentage of Component Q represents the overall value of product?
A: 47%.

Survival Strategy: Confirm all the details, and seek a binding ruling from CBP. If the widget's components can be verified as described, ABC Co. may reduce their Section 301 tariff liability by 47%.

Survival Tip: Documentation requirements to support 9802 claims are critical to this strategy. ABC Co. wouldn't have bothered before, because their goods were duty-free. But these numbers might make the extra effort to meet these documentation requirements worthwhile.

HTS 9802: any product of the United States which is returned after having been advanced in value or improved in condition abroad by any process of manufacture or other means, or any imported article which has been assembled abroad in whole or in part of products of the United States

Survival Scenario #2: In Recovery

Situation: DEF Company exports 75% of their products, yet do not understand why US Customs and Border Protection (CBP) receives fees for imported goods that will be used in an exported final product. The company imports some goods which are used in the assembly of the product, before exporting it internationally. Additionally, DEF Co. noted, some of the imported components must be scrapped during the assembly process.

Q: Does DEF Co. participate in the Duty Drawback Program?
A: Not currently; although they had heard of the program, they were under the mistaken belief that CBP was no longer allowing it. This is the right time to consider this approach, with or without Section 301 tariffs, since the Administration reversed its position and drawback is available to exporters upon filing the proper paperwork.

Q: How does Duty Drawback work for exports?
A: DEF Co. will first need to apply for the Duty Drawback Program and become completely familiar and comfortable with the process. This ultimately means that refund checks arrive faster. While waiting for approval, DEF Co. can claim drawback on imports of up to five years ago, however, CBP will issue no refunds until approved.

Q: Is there a catch?
A: Yes, fees. CBP takes 1% off the top. There will also be fees assessed by the Customs broker to manage the drawback project.

Survival Strategy: The Duty Drawback Program requires patience, paperwork, and some fees. However, brokers can often reach a mutually agreeable decision on fees, and they can handle the intensive paperwork, making the process worth every penny.

Drawback Feasibility

According to Customs regulation, it is the exporter of record that is entitled to drawback. However, if goods are imported in the US, duty paid, and subsequently exported out of the country either in an Unused or Manufactured state, in most cases a company involved anywhere in the process would be entitled to a refund in duty through the Customs drawback program. An example of an exception would be goods manufactured in the US and exported to Canada or Mexico that are eligible for duty-free entry under NAFTA ('Lesser-of-Two' rule).

Survival Scenario #3: Delayed Tariffication

Situation: GHI Company is getting hammered by Section 301 tariffs. A retailer with seasonal peaks and valleys, their suppliers can't produce all the goods in just a few months. As a result, GHI Co. must stockpile inventory all year long, until it's time to ship to customers in the spring. The company is currently paying 25% duties for goods that won't sell for months. Clearly, this is a cash flow issue.

Q: Is there a way to delay payment of these duties for months?
A: Yes, there is.

Q: Does GHI Co. sell to customers outside of the US?
A: Yes, about 20% of their sales are to Canada; another 5-8% to the rest of the world.

Q: Is there a way to avoid paying duties on those products entirely?
A: Yes, bonded warehouses and foreign trade zones (FTZ).

Q: Aren't those for alcohol, tobacco, firearms, drugs, and hazardous materials?
A: Common misperception. Lots of folks use bonded warehouses or FTZs. There are many details regarding the differences between the two – it's important to know there are differences. For survival purposes, the most important thing to know is that goods enter these facilities without paying duties until the products are withdrawn from the warehouse for consumption.

Q: What is meant by "consumption"?
A: Meaning products are ready to ship to a US consumer.

Q: What about non-US consumers?
A: GHI Co. will never pay duties on those shipments.

Q: What's required to move forward with an FTZ or with a bonded warehouse?
A: Bonded warehouses and FTZs are not for the faint of heart. These are highly regulated warehouses where security must meet CBP standards and documentation must be well-managed and inventory tightly controlled.

Survival Strategy: FTZs and bonded warehouses are not for everyone. If you are willing to take on the risk, responsibility, and resource requirements to run a bonded warehouse, you will improve your cash flow. Only you know where your tipping point is, and only you know if it's a worthwhile endeavor.

Third-party logistics providers (3PLs) can help you run the numbers. If you are already engaged with a logistics partner, it's worth a conversation to see if they would consider becoming a bonded warehouse.

Survival Tip: Paying hefty duties every month until inventory is sold is a tough road to maintain. Researching and following through with bonded warehousing or FTZ not only improves cash flow, it buys time to renegotiate pricing with customers, which in turn helps bare the burden of these tariffs.

What are the benefits to a FTZ user?

- **Duty Exemption.** No duties on or quota charges on re-exports.
- **Duty Deferral.** Customs duties and federal excise tax deferred on imports.
- **Inverted Tariff.** In situations where zone production results in a finished product that has a lower duty rate than the rates on foreign inputs (inverted tariff), the finished products may be entered at the duty rate that applies to its condition as it leaves the zone (requires prior authorization).
- **Logistical Benefits.** Companies using FTZ procedures may have access to streamlined Customs procedures (e.g. "weekly entry" or "direct delivery").
- **Other Benefits.** Foreign goods and domestic goods held for export are exempt from state/local inventory taxes. FTZ status may also make a site eligible for state/local benefits which are unrelated to the FTZ Act.

Source: Foreign Trade Zones Board
International Trade Administration, US Department of Commerce

Survival Scenario #4: Presto/Change-o!

Situation: JKL Company is no longer happy with the harmonized tariff schedule (HTS) numbers assigned to their products, since they are now subject to 10-25% tariffs. They are looking for ways to change them to more duty-friendly HTS codes.

Q: How do we change our HTS classifications, so our goods are no longer subject to these onerous tariffs?

A: Reviewing the product line list for classification accuracy is a good place to start. If you don't have internal expertise, your broker can help.

Q: Our broker is super-smart, so they can come up with alternative HTS codes, right?

A: Maybe. Their No. 1 priority should be to protect JKL Co. from risk, so they should provide a well-reasoned argument for any HTS changes that enable you to avoid tariffs. Obtaining a binding ruling from CBP to confirm new HTS numbers ahead of time is highly recommended.

Q: What if the broker can't find another HTS number?

A: You could consider tariff engineering. This means you would make alterations to your product that would legitimately facilitate its reclassification to a different HTS#. This option won't work for all products but might work for yours.

Q: Do you have an example of how this is done?

A: Some of JKL Co.'s fixtures are portable. They are plugged in wherever light is needed, and they are classifiable in Chapter 94 – subject to Section 301 Tariffs Tranche #3. If you were willing and able and it made sense in your cost of goods sold (COGS) analysis, you could swap out the cord for a self-contained battery power source and find yourself under HTS#8513.10—safe from 301 tariffs. Of course, a binding ruling is recommended before making any running changes to production, just to be sure of the outcome.

Q: What if JKL Co. made them flashlights?

A: Well, then they would be paying 12.5% duty versus 3.5% on portable lighting. This brings up an excellent point about how far to go to "beat the tariffs." If companies are receiving a low duty rate now, aside from the Section 232 or 301 tariffs, it may be worthwhile to ride it out.

Q: Anything else to consider?

A: If JKL Co. receives a binding ruling for an HTS number that has a lower duty rate than the Section 232/301 duty of 25%—but it's still higher than what they were paying pre-tariffs— JKL Co. would be stuck with the higher duty rate than what they had originally.

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Survival Strategy: Maintaining correct HTS classifications is one measure of good Customs compliance and of exercising reasonable care. The recent tariffs may be further motivation to review your products' classifications, and binding rulings can ensure the correct HTS numbers are assigned. Tariff engineering is another way to mitigate tariffs—though it is not an option with all products; however, it's important to weigh the cost and benefits in the event the Section 301 and 232 tariffs change.

What is tariff engineering?

The concept of tariff engineering was developed in the 1800's when high levies on certain imported parts became costly. Companies began sourcing or altering a product by choosing an alternative material or combination of materials that resulted in a different HTS classification with lower duties.

Source: *Considering Tariff Engineering?*

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Survival Scenario #5: Where, Oh Where Do We Go From Here?

Situation: MNO Company has a product that has been classified correctly—as confirmed by their broker—and cannot be modified in a manner to avoid 301 tariffs. The product ships directly to distributors and, therefore, cannot defer duties through exotic warehousing options. What to do?

Q: MNO Co. read about all these interesting ways to avoid 232 and 301 tariffs, but none apply to their situation. What can they do?

A: MNO may need to consider sourcing outside the China box.

Q: There are other places to source goods? MNO has been sourcing from China for 50 years. They know the supplier, and have grown with them.

A: Breaking up is hard to do. But it may be time to consider other countries in Asia or, perhaps, near-shoring. These products are not tech-intensive. It's possible MNO could make them elsewhere and, with other savings such as reduced freight costs and/or leveraging a Free Trade Agreement or Generalized System of Preferences, they could come close to the same landed cost as Chinese goods.

With which countries does the US have Free Trade Agreements?

- Australia
- Bahrain
- Chile
- Colombia
- DR-CAFTA: Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, & Nicaragua
- Israel
- Jordan
- Korea
- Morocco
- NAFTA: Canada & Mexico
- Oman
- Panama
- Peru
- Singapore

Source: *International Trade Administration*

Survival Scenario #6: Exclusion Profusion

Situation: PQR Company is out of options and the tariff train is bearing down on them.

Q: Is there anything PQR can do to stop this?
A: They can apply for a tariff exclusion.

Q: How do they do that?
A: Instructions can be found on the US Trade Representative's site.

Q: How many companies have received exclusions?
A: Not many, as in very few, but it's worth a shot. Industry groups are a good place to start. Many have resources to support members and lobbyists that can represent the industry's best interests.

Learn More About Section 301 Investigations and Exclusions

The USTR's website includes Section 301 reports, lists of companies who have requested exclusions, hearing transcripts, and other helpful information.

Source: *Office of the United States Trade Representative*

Still fighting for survival?

Speak with one of our specialists: 888-612-6239 or visit www.anderinger.com