Imports and Exports: A Short List of Common Problems and Opportunities

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Introduction

Many people are not aware of the magnitude of U.S. foreign trade. In 2014, U.S. gross domestic product totaled $17.7 trillion, with imports accounting for $2.8 trillion of this total and exports accounting for $2.3 trillion of this total. Thus, for 2014, imports (16%) and exports (13%) accounted for almost 30% of U.S. GDP. Despite the size of their import/export trade, we have found that companies often pay scant attention to minimizing their duty exposure and other risks that are part of the import/export process, even though Customs holds them primarily accountable for exercising reasonable care over these transactions. These same companies often devote substantial resources to minimizing U.S. and foreign income taxes, but have minimal internal controls for managing their foreign trade transactions. This approach is short sighted as it fails to adequately manage the risks associated with the import/export process and also fails to exploit the special tariff tools and processes that their competitors use to their advantage.

Fifty years ago, there was a much clearer line of demarcation between "domestic producers" and "importers." In today's international economy, this line is blurred, and most U.S. manufacturers and distributors deal in both domestic and imported products. In this regard, it often comes as a surprise to "U.S. manufacturers" just how much of their business involves the importation and exportation of goods.

The main "gatekeeper" in the import/export process is U.S. Customs and Border Protection, although a number of other agencies play a very crucial and active role in administering and regulating imports and exports. Customs determines the duties that apply to the products (including whether antidumping or countervailing duties are applicable), whether the products are properly valued, whether they are properly marked in accordance with U.S. law, whether they violate the intellectual property rights of other companies, and whether the products are ever admissible into the United States. In making these and other determinations, Customs enforces the laws of some 40 other government agencies.

The purpose of this memorandum is to acquaint importers and exporters with some of the key areas of concern to them. While certainly not exhaustive, these areas are on the short list of items that most commonly give rise to problems, present opportunities for reducing duties, or present opportunities for doing things more efficiently. Below are synopses of many of these key areas, with hyperlinks to more detailed articles for those who wish to explore a particular subject in more detail.

IMPORTS

Tariff Classification - The most fundamental of all Customs determinations. The tariff classification of an article determines its duty rate and its eligibility for preferential free trade programs such as GSP or free trade agreements such as NAFTA, and can alert an importer that other agencies may be interested in its products (FDA, EPA, CPSC, etc.), and can be helpful in determining whether the article may be subject to antidumping or countervailing duties or quotas. Incorrect tariff classifications almost always lead to preventable problems. For these reasons, prudent importers compile tariff classification databases and update them as new products are added and as changes in the language of the tariff necessitate.

The lawyers in Clark Hill's International Trade Practice Group have a wealth of experience in tariff classification issues and have successfully litigated a number of tariff classification cases in the U.S. Court of International Trade and the U.S. Court of Appeals for the Federal Circuit.

Customs Valuation - What do you mean the value on the invoice is not the dutiable value? Because almost all duty rates are expressed as percentages of the dutiable value of imported merchandise (ad valorem rates), determining the proper value of imported products is essential. The Customs value of goods generally is the price paid or payable by the importer, with required additions to value for items such as royalty and license fees, year-end price adjustment payments, payments to reflect currency fluctuations, "assists," and separate payments that are not reflected on the commercial invoice. These additions to value commonly are overlooked, and almost always result in problems with Customs down the road.

"Assists" are anything of value furnished to a foreign seller free of charge or at reduced cost and used in the production of the imported goods. The value of assists must be added to the invoice value to arrive at the total Customs dutiable value of imported merchandise. Common assists consist of tooling, machinery and equipment, components, and engineering and R&D, where such engineering and R&D is undertaken outside the U.S. Customs initiates a large number of penalty cases each year for failure to declare assists.

Customs closely scrutinizes transactions between related parties (5% or more of voting stock) and examines the circumstances of sale to satisfy itself that the relationship between the parties did not influence the price paid or payable. It has become increasingly routine for related parties to retroactively adjust prices, often on a yearly basis. In general, Customs requires the tender of additional duties where post-importation price increases occur, but will not refund duties where post-importation price reductions have occurred. An important exception to this general rule exists where post-importation price decreases occur between related parties pursuant to a formula that the importer uses when filing its income tax returns.

Many importers purchase product through "middlemen" such as agents or trading companies. We routinely assist in structuring transactions so that the price from the factory to the middleman is acceptable to Customs as the dutiable value of the imported goods instead of the higher price from the middleman to the importer.
Free Trade Agreements/Trade Preferences - Significant duty savings, but a potential downside. The U.S. has over a dozen free trade agreements with various countries, including Canada, Mexico, Australia, Dominican Republic-Central America, Colombia, Israel, Singapore, and Korea, and currently is negotiating FTAs with the EU and a group of Pacific Rim nations. In addition, the U.S. offers duty free entry to the goods of a number of developing countries under trade preference programs such as the Generalized System of Preferences (GSP). There are more than 100 GSP-eligible countries, including Brazil, Ecuador, Egypt, India, Indonesia, Pakistan, Philippines, Serbia, South Africa, Thailand, and Ukraine. Determining the eligibility of products under these trade preferences and trade agreements can be complicated and is often misunderstood, resulting in erroneous duty free entry claims. Customs has begun more closely monitoring claims made under FTAs and preference programs, so importers entering goods under any of these regimes should satisfy themselves that their products meet all eligibility requirements.

Antidumping and Countervailing Duties - What do you mean the duty rate is 404%? Antidumping duties ("ADD") are imposed to offset unfairly priced imports that are sold in the foreign market at prices higher than to the U.S. market. Countervailing duties ("CVD") are imposed to offset subsidies paid by foreign governments for the purpose of promoting exports. Both ADD and CVD can be imposed at the same time, and individually or collectively, ADD and CVD rates can be prohibitively high. For example, the ADD and CVD rates on aluminum extrusions from China currently total 171% of the Customs dutiable value of those goods. Moreover, the scope of ADD/CVD orders often are construed very broadly, thereby covering products that at first glance might not appear to fall within the scope of the orders. For example, in the aluminum extrusions case, the orders apply not only to aluminum extrusions, but also to a wide variety of products made from or containing aluminum extrusions.

A good number of importers become aware that ADD and CVD apply to their products only after the goods have been imported. In some instances, Customs seeks recovery of these duties going back several years, along with sizable penalties.

Country of Origin Determinations and Country of Origin Marking - Are you telling me we have to put country of origin labels on 10 containers of parts before we can sell them? With few exceptions, every article imported into the United States must be marked with its country of origin. Improperly marked products can be seized and forfeited, denied entry, subjected to liquidated damages equal to the value of the goods, subjected to penalties, or assessed special 10% marking duties. Country of origin marking issues often affect an importer's entire product line and have the potential to severely delay the timely delivery of goods. The appropriate use of the "Made in U.S.A." mark, which is governed by the Federal Trade Commission, also is a common issue addressed by Clark Hill lawyers. This area has received a lot of attention lately because of private, third party actions brought against manufacturers for violating state laws governing use of the "Made in U.S.A." claim. For example, under California law, products may be marked "Made in U.S.A." only if every single component is of U.S. origin.

It is not at all unusual today for a finished product, component, or subassembly to be assembled in one country from components sourced from a number of countries. Determining the country of origin of the finished good is becoming increasingly complex. This process is significant because the country of origin can determine whether the article is fully dutiable or duty free under a free trade agreement or tariff preference program. Country of origin also determines whether a product is subject to antidumping and countervailing duties.

Intellectual Property Rights - Your company may not have had to deal with infringing imports - yet. Importers can record their trademarks, trade names, and copyrights with Customs, and Customs will examine imported merchandise to ensure that it is not infringing. Customs seizes and forfeits large quantities of infringing merchandise each year, and registering marks with Customs delivers a lot of bang for the buck.

Another potent weapon against imports that infringe intellectual property rights is provided by the International Trade Commission (ITC) under Section 337 of the Tariff Act of 1930, as amended. In Section 337 cases, the ITC conducts "fast track" proceedings that examine the validity of U.S. patents, trademarks, and copyrights. These cases are concluded in a year, and if successful, result in the issuance of enforceable exclusion orders that bar the importation of infringing foreign products. U.S. Federal district courts are not required to defer to ITC determinations, but often do so. For this reason, a high percentage of parallel Federal district court cases are settled without trial once a favorable ITC determination has been made.

Drawback - Why am I hearing about this only now? Drawback programs permit companies to recover 99% of the duties they paid on imported merchandise under certain circumstances. There are two types of drawback: unused merchandise drawback and manufacturing drawback. Unused merchandise drawback can be used when the imported merchandise is not "used" in the U.S. and is exported within 3 years of importation. The following operations are not considered a "use" and therefore are permissible: testing, cleaning, repackaging, inspecting, refurbishing, repairing, reworking, freezing, blending, cutting, sitting, adjusting, replacing components, unpacking, and disassembling.

Manufacturing drawback is used when the imported materials or components are used in the manufacture of articles that are exported from the United States. Clark Hill's International Trade lawyers have substantial experience with the complex regulations governing drawback and regularly advise clients regarding the establishment of drawback programs or in contesting denial of drawback.

Special Tariff Provisions - How much did you tell me we can save? Is this something new? The U.S. tariff schedules contain many special tariff provisions that are of substantial benefit to U.S. importers and exporters. For example, one tariff provision permits deducting from dutiable value the cost of fabricated U.S. components that were assembled abroad into the imported article. This tariff provision is widely used by the automotive, wearing apparel, and electronics industries. Another widely-used provision covers articles (U.S. or foreign) sent abroad for repairs or alterations. Upon return to the U.S., duties are assessed only against the value of the repairs or alterations.

Although special tariff provisions are often "fleshed out" by the Customs regulations, in most instances they can be understood only after interpreting Customs rulings on the subject. For example, the term "alterations" means that the article shipped abroad must be fit for its intended use at the time of
exports and “alteration” means that the operations abroad fit it for a different use. Thus, the tariff provision covering articles sent abroad for repair or alteration does not apply where the exported articles are not fit for their intended use and the operations conducted abroad are simply part of the finishing operation that makes the article fit for its intended use. The point is that the language in special tariff provisions often employs terms of art that may not convey the actual parameters and requirements of the provision. Many companies learn this distinction the hard way when they are required to pay duties on the full value of what they thought was an article sent abroad for “alterations.” In appropriate circumstances, special tariff provisions can be used to good effect. However, it is incumbent upon importers to familiarize themselves with the meaning and requirements of these provisions before using them.

**Customs Penalties - Customs has assessed a penalty against us of how much?** The most common causes of Customs penalties are tariff classification errors, failure to declare assists, failure to declare antidumping and countervailing duties, trademark infringement, improperly claiming duty free entry under trade agreements or special tariff programs, failure to declare payments made to foreign suppliers that are not reflected on the invoice price of the goods, and failure to comply with the requirements of other government agencies, such as FDA, EPA, CPSC, USDA, etc. Customs penalties are among the most severe of any agency. Penalties in the range of 2 to 4 times the loss of revenue (plus repayment of the loss of revenue) are not unusual. Moreover, loss of revenue in these cases often is substantial as the statute of limitations covers merchandise imported over the previous 5 years. Thus, the monetary losses incurred by importers for Customs violations are routinely doubled or tripled. Our attorneys have an excellent track record in minimizing or eliminating importers’ penalty liability. We also routinely assist importers in preparing voluntary disclosures of violations, which usually reduce the penalty assessment to repayment of the loss of revenue plus interest.

**Customs Compliance Programs and Customs Audits - Compliance programs pay for themselves.** Importers must exercise “reasonable care” in determining the classification, value, and country of origin of imported goods, and must monitor their compliance with all the other laws and regulations governing the imported merchandise. An effective compliance program is essential to meeting the “reasonable care” standard. Clark Hill's International Trade lawyers have helped numerous clients implement compliance programs that are tailored to their specific needs.

To ensure compliance, Customs conducts regular audits, some of which can last for years. However, where an importer can demonstrate that it has an effective compliance program and that it is following its own internal procedures, the scope of an audit may be greatly reduced to Customs testing a small sample of transactions. If it is satisfied that the procedures are being followed and it discovers no significant violations during the sampling process, Customs routinely concludes the audit in a few months. We regularly guide importers through this complex and sometimes time-consuming process.

**Foreign Trade Zones - FTZs help U.S. companies reduce costs of manufacturing and distribution.** An FTZ is an area that for Customs duty purposes is treated as being outside the commerce of the United States. Candidates for FTZs include manufacturers who import raw materials and components, as well as distribution companies that import over $50 million per year (can be through multiple facilities).

When a manufacturer admits merchandise into an FTZ, it may elect to pay duty on the imported article based upon its condition at time of admission to the zone or its condition at time of transfer from the zone. This is called the "inverted tariff" and can result in substantial duty savings. Major industries using the FTZ program include but are not limited to:

- Automobile manufacturing and assembly
- Petroleum storage, refining, and blending
- Pharmaceutical manufacturing
- Aerospace manufacturing and assembly
- Electronics assembly

For manufacturers and distributors, the weekly Customs entry authorized for FTZ users can result in saving more than $320,000 per year in Customs merchandise processing fees. In addition, Customs duties are deferred until after merchandise is transferred from a zone to the U.S. Moreover, where foreign merchandise is exported or scrapped (e.g., obsolete materials, components, or finished products), no duties are ever paid. See the FTZ benefits estimator for the savings in duties manufacturers can realize from the inverted tariff.

**Vessel Manifests and Your Proprietary Data - My company’s confidential import/export data is available to my competitors?** Vessel manifests provide a wealth of information about a shipper's business, including a description of the imported/exported goods, the names of suppliers, consignees, importers, piece count, and weight. Many importers and exporters assume that this information is confidential. However, it is readily available to anyone unless confidentiality is expressly granted by Customs. Of particular concern to importers and exporters is the availability of their shippers’ and consignees’ names and addresses and a description of the goods. For a few hundred dollars, your competitors can discover your sources of supply and customers. We assist importers and exporters in filing confidentiality requests with Customs and monitoring the manifest reports to make sure that Customs continues to suppress this confidential information.

**EXPORTS**

**Exports Subject to Control and the Agencies Involved - Everything exported from the U.S. and some things that aren’t are subject to export controls.**

All U.S. items, which include commodities, software, and technology, are subject to control when exported from the United States, and may remain subject to U.S. controls when exported to a third country. The level of control depends on the nature of the item, its destination, the end-user, and the end-use. Most U.S. export controls are administered by two agencies, the Commerce Department's Bureau of Industry and Security (BIS) and the State Department's Directorate of Defense Trade Controls (DDTC).

- BIS, under the Export Administration Regulations, regulates exports of commercial items with potential military applications (“dual-use” items).
- DDTC, under the International Traffic in Arms Regulations (ITAR), regulates exports of items and services...
specifically designed for military uses.

The third agency involved in export controls is the Treasury Department's Office of Foreign Assets Control (OFAC), which administers and enforces economic and trade sanctions against targeted countries and individuals to achieve particular foreign policy and national security goals. The controls may include restrictions or embargoes on imports, exports, investment, foreign transactions, and travel. OFAC maintains a List of Specially Designated Nationals (the "SDN List"), which identifies individuals known to assist target countries, terrorism sponsoring organizations, narcotics traffickers, and arms dealers. Transactions with SDNs are prohibited.

**Deemed Exports - How can we be guilty of export violations when we don't export?** Technology can be exported without leaving the country. A "deemed export" occurs when foreign nationals are given access to technology in the United States. Depending on the nationality of the foreign national and the nature of the technology, a license may be required before the foreign national can access the item. The issue typically arises when foreign nationals are employed in the U.S. Employment of foreign nationals in the U.S. who have access to controlled items also may raise immigration issues because certain types of visas require the employer to certify whether the controlled technology will be released to the employee as part of his or her job.

**Encryption Items - Not just for highly sophisticated goods.** Items that have the capability to encrypt or decrypt data are subject to specific export controls. There is a common misconception in the trade community that only highly sophisticated encryption items are subject to export controls. This is not the case as items such as WIFI routers and set-top cable TV boxes are covered by encryption controls.

**Export Control Reform - Is there anything I should be doing differently?** In 2013, BIS and DDTC implemented the first stage of the President's Export Control Reform (ECR) Initiative. ECR is an ambitious project that will result in the removal of many items from the U.S. Munitions List. These items will then become controlled by BIS. The items covered by ECR are generally those that may be specifically designed for a military application such as a Humvee axle, but do not warrant control as a defense article. ECR requires companies involved in the defense trade to reconfigure their processes to comply with BIS controls.