

## Daily Tax Report ®



The Hapag-Lloyd AG Leverkusen Express sails out of the Yangshan Deepwater Port in Shanghai. The U.S. trade war with China creates uncertainty for businesses importing and exporting.

Photographer: Qilai Shen/Bloomberg

## INSIGHT: Trade Wars—Global Protectionism as a Threat to Cross-Border Transactions

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President Trump's trade war with China continues. What options do businesses importing and exporting have in this period of uncertainty? Adrienne Braumiller, Vicky Wu and Megan Mohler of Braumiller Law Group look at some possible solutions.



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Four lists later, President Trump has self-lauded his negotiating tactic of more and more tariffs, much to the dismay of the entire world. The trade war that began tariffs on three lists of Chinese imports has escalated at every turn.

The smaller lists, Lists 1 and 2, at 25% were meant to bring China to the negotiating table. In December 2018, List 3 at 10%, with the impending escalation to 25%, was arguably meant to motivate all parties to hurry trade talks along. Now, Lists 4a and 4b at 15%, and the slated 5% increase of Lists 1 through 3 that currently sit at 25% largely appear to be retaliatory, as if China and the rest of the world needed a reminder of the stakes.

The tariff agitation has left importers and exporters around the world to flounder until the dust settles—if it settles. Negotiations between the U.S. and China are expected to resume in mid-October. (As an update, President Trump tweeted on September 11, 2019 that the increase in tariffs on Lists 1 through 3 from 25% to 30% is delayed. The decision stems from multiple considerations—China's announcement of the exemption of 16 items from retaliatory tariffs on U.S. products and China's celebration of its 70th anniversary.)

Whatever the reason, the tariffs have been delayed until October 15, 2019. Trade talks are scheduled to resume sometime in October. Of course, that may change at any time.

Since there is no imminent end in sight, there are several solutions companies can

take advantage of in this time of uncertainty.

## Engage with Your Representatives

In the U.S., proposed action administered by a governmental agency is subject to a public comment and hearing period before changes take effect. As a result of this public comment and hearing period, [List 4](#) was divided into two parts, with certain articles not subject to the higher tariff rate until December 15, giving consumers a slight break ahead of the holiday shopping season. Hot-buy consumer products at this time of year such as laptops, cell phones, gaming consoles, clothing, and footwear items from China fall into this postponed group.

Additionally, Rhode Island companies pleaded their cases to U.S. Senator Sheldon Whitehouse (D-RI), who then introduced a bill that would require the U.S. Trade Representative (USTR) to make an exclusion determination within 30 days of submittal and include an explicit reason for denial. The delay of imposition of List 4b, and introduction of Senator Whitehouse's bill, substantiate that engaging with public rule makers is not an exercise in futility.

## Classification Review

A classification review for correctness is one of the simplest measures companies can proactively take to combat higher tariffs. Some companies may find that the correct classification does not fall on a Section 301 tariff list, or that under an updated classification the product qualifies for a specific product exclusion (more on exclusion requests later) that solves the duty problem for a specific class of products.

While some importers may hesitate to change the classification of a product at the risk of raising a red flag to customs, it is worth the cost-benefit analysis to determine whether the payment of penalties to Customs and Border Protection, if the misclassifications were ever discovered or the expense of submitting a prior disclosure to correct the errors, outweighs the added duty impact of the soon-to-be 15–30% higher tariff rate with no expiration date in sight.

An added benefit of correct product classifications is that companies are one step closer to finding a different solution, even if the correct classification falls on one of the Section 301 lists. An incorrectly classified product will only hinder other potential solutions, such as a substantial transformation analysis, tariff engineering, or sourcing availability in another country.

## Exclusion Requests

It is imperative that companies take advantage of granted exclusion requests and apply for product exclusions during the appropriate time frame for each list. Although the windows to submit requests for List 1 and 2 are closed, many submitted exclusion requests are still under review, with new rounds of acceptances published periodically. The deadline to submit exclusion requests for List 3 is September 30, 2019.

The process for Lists 4a and 4b has not been published yet, but due to the magnitude of items on these lists, it is likely that an exclusion process will be implemented.

A granted exclusion is valid for up to one year from the date of granting, and retroactive to the date the respective Section 301 duty took effect. The Section 301 exclusion request process allows for companies to use each other's granted product exclusions, if the product is classified with the same Harmonized Tariff Schedule (HTS) code and falls within the accompanying product description specified by the USTR.

List 3 boasts a sleek new portal, the USTR [website](#) to easily search submitted and granted exclusion requests, as opposed to requests for Lists 1 and 2 that were submitted on [www.regulations.gov](http://www.regulations.gov) and require more effort to track down submitted requests. Start with searching an HTS code and then review the associated product description to see if your product falls within the exclusion.

## Exclusion Requests Guidance

- [List 1](#)
- [List 2](#)
- [List 3](#)

When submitting product exclusions, the USTR is searching for a narrow set of characteristics that alert them to the severity of the additional tariff impact as a result of the Section 301 action. Factors that we have seen be persuasive include:

- whether a company may go out of business as a result of the tariffs;
- is sourcing available in the U.S. or a third country other than China that meets the necessary quality standards of the industry?
- what attempts have been made to source elsewhere?
- how sophisticated, or complex, is the technology involved in the product?
- whether the technology is proprietary;
- are there contractual stipulations to consider?
- will U.S. Customs be able to clearly administer the exclusion based on the given product description, etc?

Most importantly, the USTR is not going to take a submitter's word for it. Companies must be able to back up their claims of the detrimental impact of the tariffs with the financial figures and records.

## Re-evaluate Sourcing and Supply Chain

The Section 301 tariffs affect products whose country of origin is China. Of course, one way to avoid the tariffs altogether is to source products that are manufactured in a country other than China. Depending on the industry, this option may, or may not, be available to utilize.

If a search for another source comes up short, another measure to consider is whether a product can possibly undergo a "substantial transformation" in a third country. Substantial transformation occurs when a product emerges from further processing as a new and different article with a different name, character, or use. When a substantial transformation occurs, the country where the transformation takes place imparts that country as the product's country of origin.

Unfortunately, substantial transformation is a very fact- and product-specific endeavor. There is a progeny of U.S. Customs rulings and U.S. case law for various products to determine whether a process successfully achieves a substantial transformation. Minor processing in a third country, or minor assembly, rarely equates to substantial transformation.

It is important to analyze your business's supply chain and determine if there is room for transitioning a part of the process to a third country as to effectuate a substantial transformation of parts into your final good. This analysis is complex, and businesses should consult a trade law attorney or expert before exploring this option.

## Tariff Engineering and Disaggregation

Tariff engineering involves creating a product that is engineered to fit a specific classification description, with perhaps a lower duty rate, and importing the product under that HTS code. In some cases, importers bring products in under a lower duty rate/classification but intend, post-importation, to easily alter the product to perform a different use or function entirely.

Although a consideration, companies should think twice before implementing tariff engineering as an option around the Section 301 tariffs. A recent case from the U.S. Court of Appeals for the Federal Circuit ruled in [Ford Motor Co. v. United States](#) that tariff engineering of passenger vans actually intended to be sold as cargo vans was illegitimate, and not a valid practice in that case.

Ford imported its Transit Connect vans under a classification for passenger vehicles



because of features a passenger vehicle would have, like back seats, back windows, and rear-passenger footwells. Post-importation, the easily removable rear passenger seats would be removed and other slight modifications to use the van as a cargo van would be performed to eventually sell the van for cargo use. Although the Court of International Trade determined a legitimate tariff engineering change occurred, the Court of Appeals reversed, disallowing this practice in this instance because it interpreted the passenger van classification as a “use provision” (i.e., that the imported vans had to be used as passenger vans).

An alternative to tariff engineering is disaggregation. “Disaggregation” means importing components subject to lower duties, separately, and then assembling the components in the U.S. post-importation rather than importing the final product at a high duty rate.

The uncertainty of the permanence of Section 301 tariffs makes importers and exporters wary of moving production to a new country, and in some cases, the option does not exist.

No matter the business, there are options to consider before passing added cost on to the consumer. Give your situation the consideration it is due and stay up to date on the latest trade war developments.

## Planning Points

- Engage with U.S. Congressmen and Congresswomen:
  - List 4 was broken into two lists after affected constituents spoke out about the abrupt impact;
- Perform classification review;
- Request product exclusions:
  - The List 3 deadline is September 30 while the List 4a and 4b exclusion request process remains to be determined;
  - Take advantage of already granted exclusion requests by HTS number and product description;
- Work with procurement to reevaluate sourcing and supply chain:
  - Re-source products from a country other than China;
  - Effectuate substantial transformation in a third country;
- Consider tariff engineering/disaggregation.

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