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Preparing for Tariff Increases – Mitigation Strategies

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During the 2024 U.S. presidential campaign, President-elect Donald Trump promised to impose a variety of new tariffs. President Trump may seek to immediately apply levies of up to 20% on all imports, 25% on items from Mexico and Canada, and 60% on items from China (link to prior alert). To mitigate some effects of the additional tariffs, many importers have already started to evaluate the applicability of well-known methods to avoid, exclude, delay, or recoup the expected tariffs, as described below.

Exclusions. The U.S. Trade Representative (USTR) has the discretion to grant exclusions from Section 301 tariffs on a case-by-case basis. An exclusion refers to a temporary suspension or removal of certain goods from the list of goods subjected to tariffs. When available, a U.S. stakeholder may request an exclusion for specific goods from the additional tariffs. For the Section 301 tariffs, USTR generally manages applications for exclusions through an online portal allowing applicants to identify goods with detail, provide reasoning for the exclusion, and to submit the request (link to prior alert). A similar exclusion process may be instituted for some of the additional tariffs proposed by Trump, so importers should remain alert and prepared to file exclusions as applicable.

Before the first Trump administration, however, Section 301 exclusions were not prominently used. For example, the USTR granted exclusions to certain products from retaliatory tariffs, including (i) in 1985, during negotiations to resolve trade disputes with Japan over semiconductors; (ii) in 1993, during a dispute over the EU's banana import policies; and (iii) in 1997, during a dispute with Canada over dairy pricing.

Free Trade Agreements. The U.S. currently has fourteen Free Trade Agreements (FTAs) with 20 countries, most notable the US-Mexico-Canada Free Trade Agreement (USMCA). FTAs provide the framework for member countries to trade with less friction from tariffs and other trade barriers. If an imported good qualifies for FTA preferential treatment, then an additional tariff imposed across-the-board on that good from all countries may still be avoided in certain instances, depending on the legal basis used to impose the additional tariff.

Change Country of Origin. In the U.S., unless there is an exception, every article of foreign origin must be marked with its country of origin.[1]

A widely considered mitigation strategy to avoid additional tariffs involves reviewing possible changes to the good's country of origin – the country where the good was manufactured, produced, or grown. If the good is comprised of components from several countries, then the last country where the good was substantially transformed becomes its country of origin. Substantial transformation occurs when a good is fundamentally changed in form, appearance, nature, or character. For example, when a piece of steel from country A is stamped in country B to form a door panel, the stamping process occurring in country B substantially transforms the piece of steel into a door panel thereby changing the country of origin to country B. The substantial transformation analysis remains important, as this analysis determines the country of origin for the application of trade remedies under Section 301, Section 232, and Section 201.

The USMCA provides that Canada, Mexico, and the U.S. specify rules defining "country of origin" for marking purposes. The USMCA Marking Rules[2] set forth specific rules of origin in 19 C.F.R. §§ 102.1 to 102.18 and 19 C.F.R. § 102.20 which determine the country of origin for marking purposes. If a good does not meet the specific rule of origin for marking purposes, then the material that imparts the "essential character" of the final good is considered the country of

origin for marking purposes.

Tariff Engineering. Tariff engineering provides another widely utilized strategy in avoiding or lessening tariffs on imports and is referred to as a proven and legitimate way for importers to lower their duty liability. This strategy involves modifying the goods that originate in a certain country with a higher tariff rate to be substantially transformed with goods from a lower tariff rate country, so that when imported into the U.S., the imported good enjoys a lower tariff rate. For example, importing completed subassemblies or components for further assembly in the U.S. or another country may decrease overall tariff rates.

Foreign Trade Zones. Goods imported into a Foreign Trade Zone (FTZ) generally remain outside the customs territory of the U.S. and can be imported into the FTZ without paying duty immediately. The goods may be stored or staged with domestic goods for combination, exhibition, assembly, manufacturing, and processing. Currently, however, duty on goods leaving the FTZ for the U.S. customs territory, including Section 301 duties, may only be avoided by (i) directly exporting the good from the FTZ, or (ii) manufacturing a product in the FTZ using those components.

Bonded Warehouses. Somewhat analogous to an FTZ, in a bonded warehouse, goods may be stored, manipulated, or undergo minor manufacturing operations without payment of duty for up to five years from the date of importation. Duty payment may be avoided if the product is then exported from the bonded warehouse prior to entry or destroyed under CBP supervision. Bonded warehouses may be a credible option for companies awaiting the outcome of an exclusion request or ruling as to other potential tariff mitigation strategies.

Duty Drawback. Duty drawback provides a refund of duties, taxes, and other fees imposed on a product at the time of import. When imported goods are later exported or destroyed, duty drawback may be available. To claim drawback, an importer must submit a claim with CBP, including detailed documentation showing the imported product was either exported or destroyed. The Section 301 tariff may be recouped by using drawback.

Temporary Importation Under Bond. The temporary importation under bond (TIB) allows goods to be imported free of duty, taxes, and fees by posting a bond for twice the amount of duty, taxes, and fees that would otherwise be owed. Under a TIB, the importer must export or destroy the imported goods within a specified time or pay liquidated damages. TIBs may be used for goods that are being repaired, altered, or processed in country, that require temporary importation.

First Sale Rule. This valuation strategy can help importers lower the value of their goods, thereby lowering their duty payment. The first sale rule allows importers to base the value of a good on the price paid in the first sale of the good, rather than the price paid by the importer. Importantly, the U.S. importer must declare use of the first sale rule at the time of entry by providing documentation showing the first sale is a bona fide sale, and the good was clearly destined for export to the U.S. at the time of first sale. Consider the following example: A manufacturer in Taiwan sells a widget to a trading company in Australia for $20. A U.S. company purchases the widget from the Australian trading company for $30. The U.S. company may be allowed to use the value of the first transaction for purposes of assessing the duty owed on the widget, provided it has supporting documentation, such as: (i) invoices from the manufacturer to the trading company; (ii) invoices from the trading company to the U.S. company; and (iii) proof the goods were destined for the U.S. at the time of the first sale.

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Litigation. Tariff increases may be challenged in U.S. courts grounded in allegations of statutory authority violations, procedural errors, or constitutional issues. For example, under Section 301 of the Trade Act of 1974, certain procedures may be required if the stated reasons for the tariff increase do not relate to unfair trade policies (link to prior alert).[3] In addition, the Administrative Procedure Act may require sufficient opportunities for comment and a reasoned analysis of the basis for a tariff increase.

Importers should carefully review the applicability of these well-known methods to avoid, exclude, delay, or recoup tariff payments. Because the imposition of additional tariffs remains in flux, importers should carefully monitor this situation. For up-to-date advice and assistance on mitigation options to tariff exposure applicable to your business, please contact your Miller Canfield attorney or one of the authors of this alert.

[1] Section 304, Tariff Act of 1930, as amended (19 U.S.C. 1304).

[2] The Marking Rules originated under the USMCA predecessor, the NAFTA (North American Free Trade Act), and were amended to be the Marking Rules to determine the country of origin for marking purposes under the USMCA.

[3] *See HMTX Industries LLC, et al. v. United States of America, et al.,* Court No. 20-00177, where the plaintiffs argue the expansion of the Section 301 tariffs were an unlawful expansion beyond the initial scope of the investigation related to technology transfer and intellectual property protection.