

US CBP issues guidance on treatment of List 4A merchandise held in FTZs; USTR grants new exclusions and issues amendments for Chinese-origin goods as well as report on WTO Appellate Body concerns

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Executive summary

On 4 February 2020, United States (US) Customs and Border Protection (CBP) issued guidance with respect to List 4A¹ duties imposed under Section 301 of the *Trade Act of 1974* (Section 301), for merchandise held in a Foreign Trade Zone (FTZ).² The guidance, issued in follow up to a Federal Register notice (FRN) announcing the reduction of the current punitive tariffs on imported products subject to List 4A from 15% to 7.5%,³ notes "[m]erchandise covered by Tranche 4A/Annex A that was admitted to a foreign trade zone under Privileged Foreign (PF) status will be subject to tariff classification at the rate of duty and tax in force on the date of filing the application for privileged foreign status."

On 11 February 2020, the US Trade Representative (USTR) published an FRN announcing four new exclusions for Chinese-origin goods subject to 25% punitive tariffs covering US\$34b⁴ (List 1⁵).⁶ In the same FRN, the USTR also issued technical amendments to previous exclusions.

On the same day, the USTR issued a report detailing US concerns regarding the World Trade Organization (WTO) dispute settlement system, specifically the Appellate Body.⁷ The 174-page report details the USTR's determination that the Appellate Body exceeds the authority it is provided under WTO rules, and highlights instances in which the overstepping of the Appellate Body has disproportionately impacted the US, comparatively with WTO member countries.

Detailed discussion

Treatment of duty reduction on List 4A in FTZs

In August 2017, the USTR initiated an investigation into China's laws, policies or practices surrounding intellectual property rights, innovation, and technology developments under the authority of Section 301 to determine if they caused harm to the US economy and commerce. The investigation ultimately determined that Chinese laws, policies and practices around the aforementioned areas did cause harm to US commerce and were discriminatory against American companies. The USTR subsequently proposed 25% punitive duties on \$34b worth of Chinese-origin goods (List 1), followed by three additional rounds of tariffs (List 2,⁸ List 3,⁹ List 4A).

List 4A carried a punitive duty rate of 15% and became effective on 1 September 2019.

Accordingly, any items subject to List 4A that were admitted into an FTZ on and after that date were required to be placed in privileged status. Under the PF rules, the rate of duty in effect at the date of the PF election is the rate of normal (i.e., Most Favored Nation) duty applicable to the item.

On 22 January 2020, the USTR announced in an FRN the reduction of punitive tariffs on imported products subject to List 4A from 15% to 7.5%, to be effective 14 February 2020. This was the first and only reduction in the recent Section 301 tariffs. The reduction was announced in conjunction with the US-China "Phase One Agreement" on 15 January 2020.¹⁰

Based on the 4 February guidance, if any of the items admitted into the zone in PF status on or after 1 September 2019 are withdrawn from the zone for entry into US commerce on or after 14 February, the item would still be subject to the 15% rate rather than the lower rate of 7.5%.

The treatment announced for the List 4A tariff reduction differs from prior punitive tariff reductions applicable to goods held in an FTZ. Specifically, it differs from the prior treatment accorded to FTZ merchandise when the Section 232 duties on Turkey were decreased from 50% to 25%.¹¹ In that case, items admitted into the zone in PF status when the rate was 50% were, upon entry into US commerce, subject to the reduced rate of 25%. The reasoning was based on Section 232 duties being applicable based on the time of entry of an item into US commerce under normal entry declaration, or for goods held in a bonded warehouse or FTZ, at the time of withdrawal from a warehouse for consumption.

For consistency purposes, that same reasoning would be expected to apply to items subject to Section 301 punitive duties. Each Section 301 notice of action implementing a new list has contained a requirement that applicable products be admitted in PF status, as well as a specific reference to the timing of the application of duties being tied to entry into US commerce or withdrawal from a warehouse for consumption.

To date, neither CBP, the USTR nor the Department of Commerce have provided clear guidance with respect to these punitive tariffs under Section 301.

In addition, it should be noted that goods held in a warehouse or FTZ which are ultimately exported are not subject to any duties, regardless of normal or punitive duty provisions.

New Exclusions and Amendments

Following the actions of punitive tariffs applied to Chinese-origin goods under Section 301, the USTR provided an opportunity for US stakeholders to request the exclusion of specific products classified within an 8-digit Harmonized Tariff Schedule of the US (HTSUS) subheading covered by each of the four tranches by establishing exclusion request processes.

Following the review of the exclusion request, the USTR issued a denial or a grant, at its discretion, based upon specified criteria and facts presented by the submitted request.

Exclusions

On 11 February 2020, the USTR granted four new product exclusions for Chinese-origin goods subject to 25% punitive tariffs under List 1. The exclusions cover four specific product descriptions:

- ▶ Centrifugal pumps, submersible, designed for use in artificial lift systems for extracting oil and gas imported under HTSUS 8413.70.2004
- ▶ Pistons and housings for hydraulic fluid power pumps of the type used in power lawn mowers imported under HTSUS 8413.91.9050 prior to January 2020, 8413.91.9060 effective January 2019)
- ▶ Furnace roll end-shafts of steel imported under HTSUS 8417.90.0000
- ▶ Multi-phase AC motors of an output of at least 5.8 kW but not exceeding 14.92 kW, each assembled with planetary gears and a gearbox imported under HTSUS 8501.52.4000

The exclusions apply as of the 6 July 2018 effective date of the \$34b punitive tariff action and will extend to 1 October 2020.

Amendments

In the same 11 February FRN, the USTR issued 29 amendments to previously granted product exclusions on List 1. The USTR notes in the FRN that the amendments are to correct typographical or other ministerial errors.

The majority of amendments appear to be technical adjustments to account for updates to the HTSUS that occur annually. For example, amendments include:

- ▶ US note 20(i)(7) to subchapter III of chapter 99 of the HTSUS is modified by deleting “or described in statistical reporting number 8413.91.9095, post January 1, 2019” and inserting “; described in statistical reporting number 8413.91.9095, January 1, 2019, through December 31, 2019; described in statistical reporting number 8413.91.9085 or 8413.91.9096 effective January 1, 2020” in lieu thereof.
- ▶ US note 20(i)(7) to subchapter III of chapter 99 of the HTSUS is modified by deleting “or described in statistical reporting number 8413.91.9095, post January 1, 2019” and inserting “; described in statistical reporting number 8413.91.9095, January 1, 2019, through December 31, 2019; described in statistical reporting number 8413.91.9085 or 8413.91.9096 effective January 1, 2020” in lieu thereof.

WTO Appellate Body report

The WTO was established on 1 January 1995 to act as an international organization to address and enforce rules and legalities of trade between nations that are members of the WTO. This role includes, but is not limited to administering WTO trade agreements, acting as a forum for trade negotiations, monitoring national trade policies and handling trade disputes, as they pertain to the 164 WTO member countries.¹²

Also established in 1995 was the WTO Appellate Body.¹³ The Appellate Body, comprised of seven persons, reviews appeals from reports issued by panels in disputes brought by WTO Members. Disputes are first referred to a panel of experts selected by the WTO Dispute Settlement Body in consultation with the parties to the dispute. The panel ruling may be appealed by either party, and the Appellate Body may uphold, modify or reverse the legal findings and conclusions of a WTO panel.

As detailed in EY Global Tax Alert, [*USTR proposes new tariffs on EU under Section 301; WTO Appellate Body set to disband*](#), dated 11 December 2019, terms for two of the three judges residing on the Appellate Body expired, leaving the Appellate Body without the requisite three arbitrators needed to preside over cases brought to the review panel. The panel had gradually decreased to three judges from the standard seven after the US repeatedly exercised its veto against the appointment of judges over the last few years.

The USTR issued a report on 11 February 2020 formally detailing concerns regarding the Appellate Body's failures to operate under the rules set forth by the WTO. Specific issues the USTR has taken issue with noted in the report include:

- ▶ The Appellate Body has failed to meet the prescribed 90-day¹⁴ deadline for deciding appeals.
- ▶ The Appellate Body has made findings on issues of fact, including issues of fact relating to WTO Members' domestic law, although only authorized to address legal issues.
- ▶ The Appellate Body has diminished the right of WTO Members to impose safeguard measures by creating a high threshold for serious injury determinations under the Safeguards Agreement.

Further, the USTR's report asserts decisions made by the WTO Appellate Body disproportionately impact the US as compared to other member nations. To support this, the USTR cites there have been 155 disputes filed against the US, far more than against any other member country. The report also discusses that disputes pursued against the US have led to a report finding that the US law or other measure was inconsistent with WTO agreements, such as the 2002 WTO Appellate Body report on *US - Section 211 Appropriations Act*, in which the Appellate Body determined that Section 211 of the *Omnibus Appropriations Act of 1998*¹⁵ violated the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The USTR concludes the intention of the report, “the first comprehensive study on the Appellate Body's failure to comply with WTO rules and interpret WTO agreements as written,”¹⁶ is to shed light on the issues at hand, not provide answers on how to resolve concerns.

WTO reform plans have been proposed, and meaningful discussion surrounding a path forward are expected to be had the WTO Twelfth Ministerial Conference (MC12) which is scheduled to take place from 8-11 June 2020 in Nur-Sultan, Kazakhstan.

Actions for businesses

Companies utilizing FTZs as a duty deferral strategy for Chinese-origin goods subject to punitive tariffs under Section 301 are encouraged to monitor any potential changes in 301 and 232 duty enforcement and to assess the impact of those changes on zone operations.

Despite the US and China reaching a Phase One agreement with the signing of the Economic and Trade Agreement, many tariffs on Chinese-origin goods remain in place. Any company involved in US-China trade should continue to

identify the potential impact of additional duties and explore mitigation strategies. Additionally, companies should review product exclusions granted to determine if applicable to company products, as well as applying for exclusions when still applicable.

With any action on the WTO Appellate Body likely months, or potentially years away, the environmental volatility between member nations will likely increase. The importance of having readily available trade data to quickly assess the consequences of actions, such as punitive tariffs, remains critical to planning in this environment.

Endnotes

1. See 84 FR 43304.
2. See [CSMS # 41538917](#).
3. See [85 Fed. Reg. 3714](#).
4. Currency references in the Alert are to US\$.
5. See 84 FR 69016.
6. See 85 FR 7816.
7. See "United States Trade Representative Report on the Appellate Body of the World Trade Organization."
8. See 83 FR 40823.
9. See 84 FR 26930.
10. See "Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China."
11. See [CSMS # 19-000257 \(5/20/2019\)](#).
12. List of WTO member countries can be found here: https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm
13. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 1867 U.N.T.S. 14, 33 I.L.M. 1143 (1994).
14. See Article 17.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes.
15. Section 211 addresses the ability to register or enforce, without the consent of previous owners, trademarks or trade names associated with businesses confiscated without compensation by the Cuban Government.
16. See endnote 7.

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EYG no. 000768-20GbI

1508-1600216 NY
ED None

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