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Indirect Tax Alert

Canada completes final ratification of the USMCA; Implementation targeted for 1 June 2020

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Executive summary

The United States (US)-Mexico-Canada Free Trade Agreement (USMCA or Agreement) was formally ratified by Canada on 17 March 2020.[1] Canada's ratification of the USMCA now allows the parties to begin the formal notification and certification processes, which are the final steps necessary for the agreement to formally enter into force. The new Agreement will replace the North American Free Trade Agreement (NAFTA), which has been in force since 1994.

Significant hurdles remain before implementation, including the drafting of the Uniform Regulations by the three countries.[2] These regulations will assist the trade community prepare for the considerable changes in the rules and regulations from the current NAFTA regulations. The Office of the US Trade Representative (USTR), led by Ambassador Robert Lighthizer, told congressional leaders on the Senate Finance Committee, on 11 March 2020, that the US will seek an implementation date of 1 June 2020.

While a 1 June 2020 implementation date is ambitious, companies should look to develop and enact new procedures ahead of the implementation date to, at a minimum, maintain and potentially improve current benefits.

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Detailed discussion

The long and complicated NAFTA renegotiation process between Canada, Mexico and the US began in August 2017. The negotiations were triggered by the US Administration's desire to "modernize" NAFTA and to address many areas needing improvement since it went into force in 1995. The successor agreement, the USMCA, was renegotiated between the parties in seven rounds over a period of 13 months and signed on 30 November 2018. However, each country's ratification process was pursued on their own domestic political timeframe.

Mexico finalized the ratification process of the agreement in June of 2019,[3] and the US followed in January 2020. Canada, after initially appearing that ratification would be delayed until later this summer, expedited ratification in March 2020 prior to a legislative recess. Now that all three countries have ratified the agreement, focus will turn to the detailed process of formal implementation.

Prior to implementation, each of the signatory countries are required to formally notify the other nations of two items: (1) that the notifying country has finalized its own internal policies and procedures required to carry out its obligations;[4] and (2) that it is satisfied that the other nations are prepared to meet their obligations.

Pursuant to the USMCA text, the agreement will enter into force "on the first day of the third month following the last notification." As of 23 March, no such notification has taken place by any of the three countries. Should the notification occur prior to the end of March by all three countries, the agreement would then enter into force on 1 June 2020.

The notification process is complex. There are numerous outstanding issues which need to be resolved before the signatory countries can take this step. On past trade agreements this process has varied.

Historically, the USTR has determined whether a country is prepared to meet its obligations under an agreement by creating a checklist of items which must be met by negotiating partners. In prior agreements these issues were raised during informal talks or multiple rounds of formal negotiations, if necessary. The US' biggest concerns will likely be whether Mexico is prepared to implement the Agreement, specifically regarding the significant changes to the labor and environmental requirements. In addition, Canada and Mexico will each have their own checklist of issues which will need to be met before notification.

While the new US implementing regulations should be in place by a June 1st date, the short timeframe creates real challenges for companies to successfully modify their procedures and operations to comply.

Actions for Businesses

Businesses should begin to prepare for the USMCA's entry into force by modelling the impact of any changes to their operations and setting plans to implement any procedural changes which may be required. Particularly for companies in the automotive and textile industries, the announced changes to rules of origin will make qualifying for existing benefits more difficult. In addition, companies should consider whether they can enjoy any new benefits under the USMCA. Companies in e-commerce or chemicals will likely benefit from new provisions, such as an increased de minimis threshold in the case of e-commerce and simpler rules of origin for chemicals.

A comprehensive understanding of current benefits under the NAFTA are essential for companies to appreciate what could be at risk under the new Agreement. Data obtained from the Customs authorities can be used to determine where there is risk for any impact. Companies should evaluate whether any changes may be required, such as to sourcing or supply chains, to satisfy new requirements and to preserve the originating status of goods under the terms of the USMCA.

Many products are facing increased requirements on regional value content while others can look forward to the easing of rules, such as the elimination of the tracing requirement in the auto industry. Understanding industry-specific impacts will be essential.

Immediate actions for companies to take include:

- Assemble relevant trade data from Canada, Mexico and the US.
- Identify applicable rules of origin, how the existing rule is currently met and how it will change under the USMCA.
- Model the impact of proposed changes (per product) and explore solutions. For example:
  - Would your company need to replace non-originating components to comply with a stricter tariff shift rule or an increased RVC requirement?
  - How close are you to reaching the current RVC rule?
  - Would you need to use a special provision, such as the self-produced (intermediate) materials rule assist in meeting qualification requirements?

- Review new origin certification and recordkeeping requirements in order to ensure future compliance of USMCA obligations and properly communicate these to other parties in the trade equation (i.e., customers, suppliers, etc.).
- Be prepared for increased enforcement such as free trade agreement audits by local customs authorities.

Endnotes

1. See EY Global Tax Alert, *Canada ratifies trade agreement with US and Mexico*, dated 17 March 2020.
2. The Uniform Regulations provide in detail the guidelines each country will need to follow in order to interpret, apply and implement the USMCA domestically.
3. See EY Global Tax Alert, *USTR Announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US*, dated 26 June 2019
4. Protocol replacing the North American Free Trade Agreement with the Agreement between the United States of America, The Unite Mexican States, and Canada, Article 2.

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