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Indirect Tax Alert

US publishes Interim Implementation Instructions and Alternative Staging Regime for auto industry; Prepares for 1 July USMCA Entry into Force

Executive summary

The United States (US), Mexico and Canada have all ratified the US-Mexico-Canada Free Trade Agreement (USMCA or Agreement) and the Agreement will go into force on 1 July, following formal notifications by Mexico, Canada and the United States in April.

In preparation for the implementation of the USMCA, US Customs and Border Protection (CBP) has released the USMCA Interim Implementation Instructions.[1]

The instructions provide general guidance as well as specifics for textile goods and automotive products. Final implementation instructions will be released prior to the 1 July entry into force and these interim instructions are subject to change pending the issuance of General Note 11 and 19 CFR 182. Industry can also expect publication of guidance for the trade community.[2]

Detailed discussion

The USMCA negotiations began in August 2017 and focused on modifying the North American Free Trade Agreement (NAFTA), in force since January 1994. The new Agreement includes major updates in Intellectual Property (IP) protection, e-commerce regulations, modifications to the origin qualification requirements to qualify textile and automotive products and raises the de minimis threshold from 7% to 10%. The interim instructions released by CBP clarify how some of these changes will be enacted prior to the release of formal Uniform Regulations.

Notable general instructions:

- The new Special Program Indicator (SPI) for the USMCA will be "S." Importers will be required to use this indicator when claiming preference upon import.
- In a change from NAFTA, while the USMCA does not utilize a standard certificate of origin (COO), the instructions provide the minimum required data elements. In the same vein, importers are now able to produce their own COO. Not surprisingly, importers are still expected to maintain proper documentation when claiming eligibility.
- The Merchandise Processing Fee (MPF) will continue to be waived when claiming preferential treatment at import; however, the MPF will not be refunded in post importation claims, such as when the product was not declared as originating at the time of import.
- Except for certain agricultural goods, the marking rules are separate from qualification rules. Said another way, a product does not need to first qualify to be marked as a product of Canada or Mexico as a prerequisite to receive preferential tariff treatment under the USMCA.
- Importers will not be subject to penalties for an incorrect origin claim if they correct a declaration within 30 days of discovering the error; however, they must pay any duties and MPF owed.

Notable instructions for textile products:

- A yarn forward approach requires the yarn and intermediate fabric to originate in a party country and final cutting and sowing of the garment to occur within a party country.
- Textile and other sets only qualify for the USMCA if every component in the set is originating, or if the entire set does not exceed 10% foreign value content (i.e., the entire set meets de minimis).
- Specific rules are laid out for short supply goods, where textiles could still originate under the USMCA if the underlying yarn and fabrics cannot be timely sourced in the Agreement's territory.

Notable instructions for automotive products:

- Labor Value Content requirement

  The USMCA introduces a Labor Value Content (LVC) calculation where automakers must certify specific percentages of content was made by high wage workers through a staging period. The ultimate content requirements are that at least 40% of vehicles, and 45% of trucks are to be made by high wage workers after a three-year staging period.

  The interim instructions provide fixed hourly rates averages that would constitute high wage work as US$16 in the United States, CA$20.91 in Canada, or MXN$304.31 in Mexico. They confirm these rates will not be tied to an exchange rate, and currently have no described method on how to account for inflation.

  The interim instructions also set forth what types of actions are included in direct production, which has been expanded beyond general assembly to include part inspection, quality control, time spent donning protective gear, receiving or giving on-the-job training, and directly servicing and cleaning lines. Additionally, they establish employee hourly base wage rates, which will exclude benefits, incentive pay and bonuses, but include overtime. The interim rules also cover timeframe options related to calculating LVC, including calculating quarterly, by the previous calendar year, averaging, and more.

- Steel and aluminum purchase requirement

  The USMCA establishes a requirement that 70% of the purchases of steel and aluminum must be originating in a party country. The instructions include a list of Harmonized Schedule (HS) codes to specify which products are subject to this requirement, which include the steel and aluminum for major stampings that form the chassis.

- Core parts requirement

The Agreement adds automotive core part requirements, where items deemed core parts are subject to have higher origin content thresholds. The instructions list subheading HS codes of the core parts subject to these increased standards.

Due to the scope of changes that the USMCA introduces, and efforts to shift production towards the manufacture of medical equipment in the face of COVID-19, automakers have asked for an automotive implementation delay until January 2021. While an automotive delay could still be approved, automotive manufacturers and wider industry stakeholders should review the provided information and prepare for a July implementation. Unrelated to the Interim Implementation Instructions, the US Trade Representative (USTR) has separately provided guidelines that will allow petitioners (e.g., North American producers of passenger vehicles and light trucks) to apply for an Alternative Staging Regime for compliance with the USMCA's rules of origin.[3]

Standard staging found in the Automotive Appendix to Chapter 4 of the USMCA[4] allows importers of certain passenger vehicles and light trucks three years to meet the published requirements.

Federal Register Notice 2020-08405 published specific requirements for alternative staging on 21 April. Under the alternative staging regime, approved importers will have an additional two years – five years instead of three – to meet the requirements, and the vehicles will have different RVC and LVC thresholds. To apply, a vehicle producer must submit a petition with a draft alternative staging plan by 1 July 2020 and a final alternative staging plan no later than 31 August 2020.

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:

- Read the Interim Implementation Instructions in detail and begin to analyze:
  - Applicable rules of origin, how the existing rule is currently met and how it will change under the USMCA.
  - Preliminary LVC and steel and aluminum content procedures (automotive, if applicable) according to the Interim Instructions.
  - New origin certification and recordkeeping requirements to ensure future compliance with USMCA obligations and preparation to communicate these to other parties in the trade equation (i.e., customers, suppliers, etc.).
- Assemble relevant trade data from Canada, Mexico and the US.
- 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 your products to meeting the proposed RVC threshold?
  - Would you need to use a special provision, such as the self-produced (intermediate) materials rule to assist in meeting qualification requirements?
- Be prepared for increased enforcement such as free trade agreement audits by local customs authorities.
- North American producers of passenger vehicles and light trucks should evaluate their ability to meet the new rules of origin (ROOs) by the 1 July entry into force and may consider applying for the Alternative Staging Regime for compliance with the USMCA's rules of origin.

Endnotes

1. USMCA Interim Implementation Instructions.
2. CSMS #42429822- US-Mexico-Canada Agreement (USMCA) Interim Implementation Instructions.
3. Federal Register Notice 2020-08405 - Procedures for the Submission of Petitions by North American Producers of Passenger Vehicles or Light Trucks To Use the Alternative Staging Regime for the USMCA Rules of Origin for Automotive Goods.
4. See the USMCA Text published 13 December 2019: https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement.

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