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Indirect Tax Alert

USTR publishes USMCA Uniform Regulations Chapters as trade prepares for 1 July Entry into Force

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Executive summary

With the United States (US)-Mexico-Canada Free Trade Agreement (USMCA or Agreement) set to take effect on 1 July, the US Trade Representative (USTR) recently released four chapters of the uniform regulations[1] necessary for understanding implementation of key provisions within USMCA. The documents released on 3 June are not the Agreement's complete regulatory text, however, they provide the legal framework related to:

- Chapter 4, Rules of Origin
- Chapter 5, Interpretation, application, and administration of origin procedures
- Chapter 6, Textiles and apparel goods
- Chapter 7, Customs Administration and Trade Facilitation

The regulations reflect US Customs and Border Protection's (CBP) USMCA Interim Implementation Instructions,[2] with the bulk of the information covering the interpretation, application and administration of rules of origin, as well as providing increased insight into the changes that USMCA enacts, especially for the automotive industry. The regulations, trilaterally agreed, also finalize treatment of sets, further define de minimis calculations and exceptions under the USMCA, as well as establish calculations for labor and steel and aluminum content pertaining to the automotive chapters.

Building a better working world

While significant hurdles remain for companies as they develop their USMCA compliance programs, a firm understanding of the released regulations will help companies prepare for the USMCA's entry into force.

Detailed discussion

The US, Canada, and Mexico began to re-negotiate the North America Free Trade Agreement (NAFTA) in August of 2017, with the intent to update and improve the trilateral agreement. The resulting agreement text, USMCA, was finalized in November of 2018. The Agreement has since been ratified by all three member countries and is scheduled to enter into force on 1 July 2020.

The uniform regulations published on 3 June 2020 document several notable general changes enacted under the USMCA. Additionally, the text offers needed insight into labor value content (LVC), averaging, and steel and aluminum content for the automotive industry.

The US has previously released non-binding text interpretations of the agreement (e.g., CBP's Interim Implementation Instructions). The uniform regulations released on 3 June mark the first binding release. While the released regulations chapters resemble the previously published documents, it is important to note that they do not mirror them entirely. As an example, under the Interim Implementation Instructions, overtime appeared to be included in calculating hourly wage rates for automotive labor value content, but it is explicitly excluded under the text of the regulations. Where differences exist, industry should rely on the uniform regulations.

Notable general updates include:

- Parties are *not required* to maintain paper certificates of origin (COOs), even for entry into Mexico, and instead can store COOs electronically
- The de minimis threshold has been raised *from* 7% to 10%, with its exceptions being updated to include, but not limited to, the elimination of exceptions for Heating Ventilation and Air Conditioning (HVAC) products and printed circuits, as well as increased de minimis exceptions for textiles
- Textile and other sets will only qualify as originating content under the USMCA *if every component* in the set is originating, or if the entire set meets the de minimis threshold
- Each of the three member countries will be required to publish all advanced rulings they have issued online, on a quarterly basis
- Recognition of "relevant documents" that may be able to prove originating status in the event of transshipment outside the territories of the Agreement, so long as the good does not undergo further processing outside of the Agreement's territory other than the processes specifically authorized by the regulations (i.e., inspection, removal of dust, chilling, etc.)
- New verification procedures which:
  - Authorize the importer's Party authority to directly audit exporters and producers in another territory while just notifying the importer
  - Further define the importer's Party authority to audit the producers and exporters of materials incorporated to a finished good under audit and potentially disqualify origin based on the materials' verification
- Stronger linkage between customs valuation rules and origin qualification
- Time extension for auto industry to respond to information requests which include documents supporting origin certification[3]

Automotive updates:

- Labor Value Content (LVC) requirement

  The USMCA introduces an LVC calculation where automakers must certify specific percentages of content are made by high wage workers. The regulations confirm how automakers should calculate this content in order to meet the ultimate content requirements for at least 40% of vehicles, and 45% of trucks are to be made by high wage workers after the three-year staging period.

  The regulations provide fixed hourly rates averages that would constitute high wage work as US$16 in the US, CA$20.88 in Canada, or MXN$294.22 in Mexico. While these rates differ slightly from those previously released in the Interim Implementation Instructions, they confirm rates will not be tied to an exchange rate, and currently have no described method on how to account for inflation.

  Further, the text finalizes which employees' wages can be incorporated into the hourly wage rate calculations. These include all relevant hours worked by full-time, part-time, temporary and seasonal workers. Wages for the LVC calculation exclude management staff with the authority to make final decisions to hire, fire, promote or transfer personnel, time spent in research and development, as well as interns, students, or any other worker that does not have an express or implied compensation agreement. The hourly rates themselves prohibit additions for costs towards worker benefits, bonuses, overtime pay, holiday pay, and shift premiums. Where temporary workers are used, only the wages received by the worker count towards hourly rates, and all other costs paid to the employment agency are excluded.

The regulations lay out what actions are included in direct production, which has been expanded beyond general assembly to include part inspection, quality control, receiving or giving on-the-job training, and directly servicing and cleaning lines.

- Steel and aluminum purchase requirement

  The USMCA establishes a requirement that 70% of the purchases of steel and aluminum must be originating in a member country. The regulations confirm that only Original Equipment Manufacturer (OEM) producers are subject to these requirements, but additional supplier tiers could be included if contracts with the OEM producers have been negotiated to stipulate where steel and aluminum will be supplied. Regulations also contain a list of Harmonized System (HS) codes that specify which products are subject to the requirements.

- Core parts requirement

  The Agreement adds automotive core part requirements, where key components of vehicles must be originating for the final vehicle to qualify. A table is included in the USMCA Uniform Regulations listing subheading HS codes of the core parts subject to these increased standards.

- Averaging

  The process and requirements for calculating LVC, regional value content (RVC), and steel and aluminum content are defined, allowing producers to elect to average monthly, quarterly, fiscally, or in other interval options, specified by calculation type.

Actions for businesses

With less than one month before the USMCA's entry into force, businesses should begin to solicit COOs from members of their supply chain. These results should be paired with USMCA impact models 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 this data, and any returned COOs to verify 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 RVC 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 uniform regulations 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
  - LVC and Steel and Aluminum Content procedures (automotive, if applicable) to determine if items will qualify as originating
  - New origin certification and recordkeeping requirements to ensure future compliance of the USMCA obligations and prepare to communicate these to other parties in the trade equation (i.e., customers, suppliers, etc.)
- Model the impact of changes to the rules of origin 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?

- Solicit certificates of origin, understanding the COO process under USMCA requires certifiers to meet minimum data criteria,[4] and there is not a proscribed form.
- North American producers of passenger vehicles and light trucks may consider applying for the Alternative Staging Regime for compliance with the USMCA's rules of origin.
- Evaluate available resources and prioritize activities according to resource availability. With the COVID situation still latent, companies may be challenged to perform all necessary activities. Consider outsourcing as needed.

Endnotes

1. USMCA Uniform Regulations.
2. CBP's USMCA Interim Implementation Instructions.
3. Such extension will be temporarily granted from 1 July 2020 through 31 December 2020 to allow flexibility to secure such documentation.
4. See Appendix III of the Interim Implementation Instructions.

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