8 May 2019
Indirect Tax Alert

US announces increase of tariffs on List 3 goods imported from China

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Executive summary

On 8 May 2019, the United States Trade Representative (USTR) announced through a Federal Register notice (FRN) that the United States (US) will move forward with increasing the tariffs on US$200 billion[1] worth of Chinese imported products (List 3) from 10% to 25%, as originally intended when implemented on 24 September 2018.[2] The FRN also announces that an exclusion request process will be formally published shortly.

While the US and China have engaged in numerous rounds of negotiation towards an agreement since last fall, in this announcement the USTR states that "China has chosen to retreat from specific commitments agreed to in earlier rounds." Citing the lack of progress in discussions with China, US President Trump has directed the USTR to increase the tariffs. The increase is set to occur on Friday, 10 May 2019 at 12:01 am Eastern Daylight Time (EDT) and will be effective for goods exported to the US on or after 10 May 2019.

Detailed discussion

On 22 March 2018, US President Trump executed a Presidential Memorandum directing the Administration to take a full range of action responding to China's acts, policies and practices involving unfair and harmful acquisition

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of US technology.[3] The USTR subsequently proposed, and US President Trump ordered, punitive duties of 25% to be imposed and collected on two lists of imports from China beginning 6 July 2018[4] and 23 August 2018[5] (List 1 and List 2 respectively). The third list of punitive duties, 5,745 tariff lines, (List 3) was effective on 24 September 2019 and was only to be 10% ad valorem duty until 1 January 2019 when it was set to automatically increase to 25%.[6]

The 1 January deadline was delayed for 90 days with a December 2018 announcement.[7] When the 90 days elapsed, the delay was renewed with a 5 March FRN announcing satisfactory progress had been made to warrant a delay while negotiations continued.[8]

List 3 is the most expansive of the lists with covered products falling within 80 Chapters of the Harmonized Tariff System of the United States (HTSUS). Pharmaceuticals of Chapter 30, and apparel and footwear of Chapters 61-64 are notably absent from the list. However, the list does include consumer products such as hats and handbags, car parts, appliances, televisions, batteries, computer components and network routers, furniture, as well as fabrics, food, chemicals and pesticides, minerals, machines, items made from steel and aluminum, and semiconductor assemblies, among others.

Unlike List 1 and List 2, there has been no exclusion process announced for List 3 to date. However, recent amendments to the *Trade Act of 1974* has directed the USTR to establish an exclusion request process for particular products classified within an HTSUS subheading covered by the September 2018 FRN. The USTR is now expected to publish a separate notice describing the product exclusion process. Interested parties should pay careful attention to the guidelines once published, but should consult those in place for List 1 and 2 subject products, as well as the results to date of those requests, for what to anticipate.

What to expect next?

The US and China are continuing negotiations despite the tariff rate increase announcement. However, it remains to be seen whether, between the start of negotiations on Thursday and the deadline of 12:01 am EDT Friday, if sufficient concessions between the two countries will be made which would result in the US agreeing to again delay the increase in tariffs. Businesses should anticipate that any imports on or after the effective date will be subject to the increased tariff rate. Further, in addition to the announcement of a potential exclusion request process, the US Administration has also indicated that it would soon announce further tariffs on the remainder of China origin products not already assessed under the prior actions. Businesses should carefully monitor future announcements for impacts.

Action for businesses

Any company involved in US-China trade is encouraged to identify the potential impact of additional duties and develop duty avoidance or mitigation strategies.

For goods already in route to the US from China, the 10% tariff rate will apply. For goods to be exported as of 10 May on, the increased 25% tariff rate will apply and therefore companies should consider admitting them in a Foreign Trade Zone or a bonded warehouse to defer the duty.

For companies sourcing products from outside of China that have the same 8-digit HTSUS code as those imported into the US and subject to the punitive tariffs, there may be an opportunity to recover 99% of the duties paid, including punitive tariffs, through qualifying substitution drawback claims. This planning opportunity is fact specific and requires additional conversation.

Once the exclusion request process is formally announced, companies should be prepared to evaluate any China-origin subject articles that it may be able to meet the request requirements for and prepare to submit upon the USTR's process becoming available. However, under the initial List 1 and 2 process, this process takes significant time and rate of success for List 1 to date has been below 15% while denials are more than 50%.

Additional immediate actions for such companies could include:

- Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs, alternative sourcing options, and to assess any opportunities to mitigate impact such as tariff engineering.
- Exploring strategies to minimize the customs value of imported products subject to the additional duties, re-evaluating current transfer pricing approaches, and for US imports, considering US customs strategies, such as First Sale for Export.

Endnotes

1. Currency references in this Alert are to US$.
2. https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-09681.pdf.
3. https://www.whitehouse.gov/presidential-actions/presidential-memorandum-actions-united-states-related-section-301-investigation/.
4. https://ustr.gov/sites/default/files/2018-13248.pdf.
5. https://ustr.gov/sites/default/files/enforcement/301Investigations/Final%20Second%20Tranche.pdf.
6. See EY Global Tax alert, *US announces tariffs on $200b China-origin goods; trade pressures to continue*, dated 18 September 2018.
7. See EY Global Tax alert, *US announces temporary pause on planned increase of List 3 tariffs on China origin goods; duties remain in force and key issues remain unresolved*, dated 3 December 2018.
8. See EY Global Tax Alert, *US Suspends Planned Increase of Duties on certain Chinese origin imports "until further notice"; Moves to remove India and Turkey from preferential trade benefits*, dated 6 March 2019.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United States), Chicago
- Nathan Gollaher nathan.gollaher@ey.com
- Helen Xiao helen.xiao@ey.com

Ernst & Young LLP (United States), Dallas
- Armando Beteta armando.beteta@ey.com
- Bill Methenitis william.methenitis@ey.com

Ernst & Young LLP (United States), Houston
- Michael Leightman michael.leightman@ey.com
- Bryan Schillinger bryan.schillinger@ey.com

Ernst & Young LLP (United States), Irvine
- Robert Smith robert.smith5@ey.com
- Todd Smith todd.r.smith@ey.com

Ernst & Young LLP (United States), New York
- Jeroen Scholten jeroen.scholten1@ey.com

Ernst & Young LLP (United States), Portland
- James Lessard-Templin james.lessardtemplin@ey.com

Ernst & Young LLP (United States), San Diego
- Lynlee Brown lynlee.brown@ey.com
- Kellie Kemock kellie.kemock@ey.com

Ernst & Young LLP (United States), San Jose
- Michael Heldebrand michael.heldebrand@ey.com

Ernst & Young LLP (United States), Seattle
- Dennis Forhart dennis.forhart@ey.com

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