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Indirect Tax Alert

US announces new import tariffs on Mexico, delays tariff increase on certain China goods and formalizes removal of India from GSP

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Executive summary

On 30 May 2019, United States (US) President Trump announced his intent to impose 5% punitive tariffs on all goods imported from Mexico beginning 10 June 2019. Total imports from Mexico are approximately US$346b;[1] therefore immediate impact would be approximately $17b if implemented as stated. The White House released an official statement suggesting that Mexico should be making an effort to curtail the illegal immigration at the border between the US and Mexico and that tariffs will stay in place until the threat is removed.[2] The statement notes that if the Mexican Government's immigration enforcement measures are determined to be effective, at the sole discretion of the US Administration, the tariffs will be removed. However, if this is not the case, the additional tariffs are proposed to increase monthly, moving to 10% on 1 July, 15% on 1 August, 20% on 1 September, and finally 25% on 1 October, where they will remain unless thereafter removed.

On 31 May 2019, the United States Trade Representative (USTR) announced a limited extension to the scheduled additional tariff increase for goods from China, from 10% to 25% for certain goods covered by the Section 301 actions from 1 June to 15 June.

Building a better working world

Also on 31 May 2019, President Trump issued a Proclamation terminating India's designation as a beneficiary developing country under the Generalized System of Preferences (GSP), effective 5 June 2019. The action further removed India's exemption from the safeguard measures in place for certain crystalline silicon photovoltaic (CSPV) cells and residential washers.

Detailed discussion

Tariffs on Mexico

In 1977, Congress enacted the *International Emergency Economic Powers Act* (IEEPA) which gives the President the authority to respond to "any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States" after declaring a national emergency.[3] On 15 February 2019, President Trump declared a state of emergency citing the "border security and humanitarian crisis that threatens core national security interests."[4] Historically, the IEEPA has been generally used to freeze or block assets of foreign nationals or foreign governments. The imposition of tariffs under the IEEPA is an unprecedented use of power under this Act.[5]

In the statement announcing the tariffs, the President demanded that Mexico act to "dramatically reduce or eliminate" the number of illegal immigrants crossing illegally into the US claiming that this can be done "easily" but not detailing specific actions. To prohibit the imposition of these tariffs, Mexico must "alleviate the migrant crisis" and such tariffs will remain "until Mexico substantially stops the illegal inflow of aliens coming through its territory." The announcement threatens the application of a 5% duty on all imports from Mexico starting 10 June 2019. If the crisis is not resolved, at the President's "sole discretion and judgement," the duty rate will increase to 10% as of 1 July, 15% as of 1 August, 20% as of 1 September, and 25% on 1 October where it will remain. If an agreement with Mexico on immigration is reached prior to 10 June, the imposition of these tariffs may be averted.

Mexican President Andrés Manuel López Obrador criticized the action by saying that economic tariffs will not fix social issues such as illegal immigration. Specifically, the Mexican President wrote a two-page letter in response stating that Mexico was doing what it could to limit illegal immigration and that social problems are not resolved via the imposition of taxes and coercive measures.[6]

It must be noted that these punitive tariffs are different from the most favored nation (MFN) duty rates the US applies to imports from all countries. While NAFTA may continue to waive MFN duty rates on Mexican originating goods, it will not waive these punitive tariffs. The Administration has not yet announced any exclusion process from the proposed tariffs and currently the tariffs are not targeted against specific products.

Effects on USMCA ratification

On 30 May 2019, the USTR, Robert Lighthizer, submitted a draft statement of administrative action (SAA) to continue the discussion with Congress and paving the way for a future vote on the final text of the agreement.[7]

Also on 30 May 2019, Mexican officials submitted documentation to the Mexican Senate to begin the ratification process of the US-Mexico-Canada Agreement (USMCA). President López Obrador has indicated publicly that the process to ratify the agreement in the Mexican Congress shall continue despite the US Administration's tariff proposal.[8] The stance of the US Administration, reinforced last night in a briefing from White House Chief of Staff Mick Mulvaney, is that the proposed tariffs are not in reaction to trade policy, rather, they are linked to national security due to immigration, and should have no impact on the USMCA or other trade-related matters between the two countries.

Actions on China

On 23 September 2018, the USTR announced tariffs on $200b of goods from China[9] at a rate of 10% until 1 December, at which time the duty rate was scheduled to increase to 25%. As previously discussed in 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, the US ultimately delayed the increase until further notice while negotiations with China ensued. However, on 8 May 2019, the US announced that the duty increase was to take place on 1 June 2019.[10]

However, on 31 May 2019, the USTR announced that the increase will now apply as of 15 June and is being provided to "further account for customs enforcement factors and the transit time between China and the United States by sea." US Customs and Border Protection (CBP) must complete programming to the Automated Commercial Environment (ACE) system for entry declarations to collect the additional tariffs. While the original implementation date for imports after 10 May is in force, the USTR provided an exception for goods that were exported from China prior to that date provided they arrived for import by 1 June.

Actions on India

On 31 May 2019, the US Administration announced in a Presidential Proclamation the removal of India as a beneficiary of the GSP, effective 5 June 2019.[11] The USTR had provided a 60-day notice of intent for the exclusion to Congress and India on 4 March 2019.[12] The proclamation cites India's failure to provide equitable and reasonable access to its markets, a key criterion in the qualification of a GSP beneficiary country, as reason for removal from the program.

The GSP was implemented as part of the *Trade Act of 1974* and became effective on 1 January 1976. The program, designed to promote economic growth in developing countries by helping countries diversify their trade with the US, provides duty-free benefits for a wide range of qualifying products listed in the US Harmonized Tariff Schedule. India was declared a GSP country in 1975, a part of the original list under an Executive Order, and has maintained ongoing status.

India was the largest beneficiary country of the program in 2018 with $6.3 billion claimed under the program.[13] The USTR 2018 report on Foreign Trade Barriers noted a $22.9 billion trade deficit in goods in 2017, where the US exported $25.7 billion to India with corresponding imports from India at $48.6 billion.[14] Limited market access to India comes in the form of both tariff and non-tariff barriers to entry. India has consistently maintained very high tariff rates, such as the 50% tariff on motorcycles, making imported goods costly. Various non-tariff barriers to entry include India's intellectual property disagreements between the two nations and burdensome requirements on targeted industries such as dairy and medical.

On 22 January 2019, the USTR announced the application of a three-year safeguard tariff-rate quota on CSPV cells and residential washers under Section 201 of the *Trade Act of 1974*, which permits the President to grant temporary import relief on goods that injure domestic industries, either by raising import tariff rates or imposing non-tariff barriers to entry.[15] Pursuant with World Trade Organization obligations, GSP beneficiary countries were exempted from the safeguard measures. With India's removal from the GSP list, the exemption from the 201 measures has also been lifted and they will be held to the applicable tariff rate quotas and increased duties.

Actions for businesses

With total 2018 imports from Mexico valued at approximately $346 billion, 55% of which entered in duty free status using the North American Free Trade Agreement (NAFTA) duty preference, this move has material impact to US industry.[16] Any company involved in US/Mexico trade is encouraged to identify the potential impact of additional duties and develop duty mitigation strategies.

Companies impacted by the tariff increase on exports from China prior to 10 May should take steps necessary to complete imports prior to 15 June as well as closely monitor CBP procedures for managing duty deposits and potential refunds while the ACE system modifications are completed.

Companies with imports from India should evaluate the overall impact from the elimination of GSP eligibility. Such actions may include considering alternative sourcing or optimizing duty planning strategies.

For all importers impacted by these matters, immediate actions for 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 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.
- Carefully reviewing contracts with suppliers and with customers to understand who has liability for increased duties and if there are opportunities for negotiation.
- When more substantive guidance is provided around the applicability of duty drawback and Foreign Trade Zones, identifying strategies to defer, eliminate, or recover the excess duties on both the US and Mexican side.

Endnotes

1. Currency references in this Alert are to US$.
2. Statement from the President Regarding Emergency Measures to Address the Border Crisis, 30 May 2019.
3. 50 U.S. Code § 1701.
4. Presidential Proclamation on Declaring a National Emergency Concerning the Southern Border of the United States, 15 February 2019.
5. *The International Emergency Economic Powers Act: Origins, Evolution, and Use*, Congressional Research Service, 20 March 2019.
6. Mexican President Lopez Obrador's Letter to President Trump, The Wall Street Journal, 31 May 2019.
7. https://ustr.gov/sites/default/files/USMCA_SAA_Cover_Letters_5.30.19.pdf.
8. Mexico Continues Trade Pact Process Despite Trump Tariff Threat, The Wall Street Journal, 31 May 2019.
9. See EY Global Tax Alert, *US announces tariffs on $200b of China-origin goods; trade pressures continue*, dated 18 September 2018.
10. See EY Global Tax Alert, *US announces increase of tariffs on List 3 goods imported from China*, dated 8 May 2019.
11. https://www.whitehouse.gov/presidential-actions/proclamation-modify-list-beneficiary-developing-countries-trade-act-1974-2/.
12. 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.
13. https://ustr.gov/sites/default/files/files/gsp/GSP_By_The_Numbers_March_2019.pdf.
14. https://ustr.gov/sites/default/files/files/Press/Reports/2018%20National%20Trade%20Estimate%20Report.pdf.
15. https://ustr.gov/sites/default/files/files/Press/fs/201%20FactSheet.pdf.
16. https://ustr.gov/countries-regions/americas/mexico.

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