

USTR grants new exclusions to Lists 1, 2 and 3 for China origin goods; US and Japan reach agreement on trade in goods and digital trade

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Executive summary

On 20 September 2019, the United States (US) Trade Representative (USTR) published newly granted exclusions for Chinese origin products subject to punitive tariffs on Lists 1, 2, and 3 in three separate Federal Register Notices (FRN).¹ The action follows the 11 September announcement to increase punitive tariffs from 25% to 30% on certain products.²

The announcements are as follows:

- ▶ Exclusions on 310 products otherwise subject to a 30% punitive tariff as part of the 818 tariff lines covering the \$US34 billion³ worth of imports from China annually (List 1⁴).⁵
- ▶ Exclusions on 89 products otherwise subject to a 30% punitive tariff as part of the 279 tariff lines covering the \$16b worth of imports from China annually (List 2⁶).⁷
- ▶ Exclusions on 38 products otherwise subject to a 30% punitive tariff as a part of the 5,745 tariff lines covering the \$200b worth of imports from China annually (List 3⁸).⁹

Additionally, on 25 September 2019, US President Donald Trump and Japanese Prime Minister Shinzo Abe made significant advancements towards a formal US-Japan Free Trade Agreement. During a joint press conference at the

United Nations General Assembly (UNGA) in New York City, the two leaders signed a trade-enhancement agreement that is intended to lower tariffs between the two nations once implemented. Additionally, a separate agreement addressing digital trade was reached.¹⁰ These actions have been perceived as the first step towards a full-fledged free trade agreement.

Detailed discussion

Product exclusions

Beginning in August 2017, following the directive in a Presidential Memorandum,¹¹ the USTR launched an investigation into China's trade policies under Section 301 of the *Trade Act of 1974*.¹² Following the completion of the investigation, the USTR imposed a series of punitive tariffs on approximately \$250b worth of Chinese origin goods, known as Lists 1, 2 and 3. Each of the three lists currently assess a 25% punitive tariff upon importation and entry into the US Commerce; however, these tariffs are presently scheduled to increase to 30% on 15 October unless further directives delay or modify the announced increase and its anticipated effective date.¹³

The USTR's 20 September 2019 announcements reaffirm that product exclusion decisions will be made based on the criteria stated in the notices establishing the exclusion process. Specifically, the criteria require applicants to provide the following detailed information for consideration of a determination to grant an exclusion:

- (1) Availability of the product outside of China
- (2) Harm to US interests due to additional tariffs
- (3) Significance of the product to Chinese industrial policy
- (4) Whether an exclusion would undermine the objective of the Section 301 investigation

The FRN details regarding List 1 added a new specific Heading, 9903.88.14, for reporting the products now covered by the latest exclusions. The latest exclusions apply to 310 products by specific descriptions. See below for examples of some of the products granted exclusions:

- ▶ Certain heat exchangers imported under 8419.50.5000
- ▶ Water filters imported under 8412.21.0000
- ▶ Certain GPS apparatuses imported under 8526.91.0040
- ▶ Printed circuit connectors imported under 8536.69.4040

- ▶ Certain medical equipment and parts imported under 9018.19.9560

The FRN details regarding List 2 added a new specific Heading, 9903.88.17, for reporting the products now covered by the latest exclusions. The latest exclusions apply to 89 products by specific descriptions. See below for examples of some of the products granted exclusions:

- ▶ Certain plastic straws imported under 3917.32.0050
- ▶ Certain sheets of polyvinyl chloride imported under 3921.90.4090
- ▶ Certain items of iron and steel, such as pipes and posts, imported under 7308.90.3000
- ▶ Solar panels imported under 8541.40.6015 and 8541.40.6035
- ▶ Certain conductors imported under 8544.49.2000

The FRN details regarding List 3 added a new specific Heading, 9903.88.18, for reporting the products now covered by the latest exclusions. The latest exclusions apply to 36 products by specific descriptions. See below for examples of some of the products granted exclusions:

- ▶ Certain O-rings made of rubber imported under 4016.93.1010
- ▶ Portable, single use grills imported under 4402.10.0000
- ▶ Fuel pumps for internal combustion imported under 8413.30.9030
- ▶ Certain printed circuit assemblies imported under 8473.30.1180
- ▶ Miniature lighting sets for Christmas trees imported under 9405.30.0010

As of 20 September 2019, the USTR had denied 6,864 or 63.43% of the 10,814 requests for List 1, 1,585 or 54.28% of the 2,869 requests for List 2. As described in 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, the USTR announced an exclusion procedure for List 3, which will close 30 September 2019.

The denied exclusions, as well as the total granted, are further illustrated in the below table. As, there has been no exclusion procedure yet announced for List 4, close monitoring is advised for companies impacted by covered items, and as such, List 4 is excluded from the below table.

	Total requested	Granted	Denied	Stage 2 ¹⁴	Stage 3 ¹⁵
List 1	10,814	3,530	6,864	1	419
List 2	2,869	689	1,585	9	586
Total	100%	30.8%	61.7%	0.1%	7.4%
List 3	16,519	61	94	16,346	0

The exclusions, once granted, are retroactive to date of import, and therefore companies may claim refunds on punitive duties already paid on the now excluded products. The refund request process for punitive duties paid on products that have been granted exclusion for List 2 has been published by Customs and Border Protection (CBP) via the Cargo Systems Messaging Service.¹⁶ To claim a refund, importers must file a post-summary correction (PSC) on affected entries within the prescribed timeframe for PSC filings (i.e., before liquidation). In the event the entry has already been liquidated, the liquidation may be protested.

Notably, the FRN for exclusions granted for List 3 provide a concrete ending period on 7 August 2020. All previous exclusions, including for the same list, have addressed expiration of the exclusions by stating they would expire within one year from publication of the FRN that granted the exclusion. The defined date of 7 August therefore will limit the period of time that an exclusion will be in force and effected parties should consider the need for long-term planning to offset this impact, especially in consideration of the large volume of exclusion requests to date for List 3 and the likely timeline to receive a favorable outcome is limited.

US-Japan agreements on trade and digital

On 25 September 2019, President Trump and Prime Minister Abe signed a limited trade agreement between the two nations at the UNGA in New York City. The negotiations, which began earlier this year, are expected to continue towards the next stage of a comprehensive trade deal negotiation that will address remaining tariff and non-tariff barriers between the two trading partners.

The partial trade deal focuses on enhanced market access to Japan for the US agriculture industry. Prior to the agreement being signed, \$5.2b of the \$14.1b of annual US agricultural exports to Japan were duty free. The new deal will lower or eliminate over 90% of Japanese import tariffs on \$7.2b of American agriculture goods, as well as providing the US agriculture industry the same preferences as member countries of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP).¹⁷ The tariff reductions are grouped into three large categories, with differing reductions and timing.

The implementation of the tariff reductions on \$2.9b of US origin agriculture goods will occur in stages and cover products such as fresh and frozen beef and pork. Tariff elimination on \$1.3b of US origin farm products will occur immediately upon entry into force and include the removal of tariffs on products such as almonds, cranberries, and broccoli. Additional tariff elimination on \$3b of US origin goods such as wine, cheese, oranges and egg products will happen in a staged elimination.

In return, the US will reduce or eliminate tariffs on 42 tariff codes of agricultural imports from Japan such as persimmons, green tea and chewing gum, as well as other products such as machine parts, bicycles and musical instruments.

Notably, the deal does not provide any immunity from punitive tariffs on Japanese origin autos under Section 232 actions, nor Japan's desired outcome of removing the Most Favored Nation tariff rate of 2.5% presently assessed on passenger automobiles. However, Prime Minister Abe has been quoted saying that discussions have occurred between himself and President Trump who has confirmed that there is no threat that additional tariffs will be imposed at this time. Additionally, USTR Robert Lighthizer noted the two nations will further address automotive aspects of trade at future next rounds of comprehensive negotiations.

Separate from the details on trade in goods which are designed to achieve a more favorable trade balance between the two countries, the two leaders signed a second agreement that addresses digital trade, which in substance is the same as the new digital trade provisions set forth in the United States - Mexico - Canada Agreement (USMCA). This includes prohibitions of customs duties paid on products transmitted electronically such as software and music, and cross-border data transfers without trade barriers. In its statement on announcing the agreement, the USTR stated “The digital trade agreement with Japan meets the gold standard on digital trade rules set by the USMCA and will expand trade in an area where the United States is a leader.” This result follows the Trump Administration’s Trade Agenda objectives as presented to Congress in establishing such standards and in its bilateral negotiations with a number of trading partners.

The agreement is expected to enter into force in January 2020 if the legislative process via the Japanese Diet results in formal ratification of the agreement before year-end. As the agreement is an executive agreement within the US, there is no Congressional approval required. Therefore, it will be implemented at the discretion of the US Administration concurrent with the Japanese actions.

In a joint statement regarding the agreement, both nations have noted the intention to continue negotiations within four months of the entry into force of the partial agreements, working towards a comprehensive agreement regarding both tariff and non-tariff barriers to entry in the spirit of mutually beneficial free trade. Additionally, the joint statement emphasized the trust and good will between the two nations as conversations around trade continue.¹⁸

Actions for businesses

Companies with exports to China are encouraged to evaluate the recently announced exclusions and determine eligibility for seeking potential refunds. See prior EY Global Tax Alerts for more details on mitigation strategies that may be available for products subject to these duties. Additionally, China is continuing to accept exclusion requests from importers and US-based companies with China List 3 items¹⁹ should be aware of such opportunities in negotiating with customers.

Additionally, companies importing goods from China that are included on List 4 are encouraged to closely monitor and participate in any exclusion process the USTR may issue. Companies should actively develop procedures to support necessary documentation for imported goods that will be subject to List 4, as similar to the past actions, where subject goods ultimately receive exclusion status after the tariff imposition date are expected to be eligible for a refund on punitive duties paid through the PSC procedures.

Companies involved in US-Japan trade should closely monitor the progression of the formal trade deal that is anticipated to result from the recent agreements, and once further details are announced, analyze potential benefits available and any potential operational changes necessary.

Endnotes

1. Punitive tariffs of Lists 1, 2 and 3 are executed by the USTR under Section 301 of *The Trade Act of 1974*.
2. See EY Global Tax Alert, [China publishes first punitive tariff exclusions while US postpones 5% increase to Lists 1, 2 and 3; other regional trade developments](#), dated 13 September 2019.
3. Currency references in the Alert are to US\$.
4. <https://ustr.gov/sites/default/files/2018-13248.pdf>.
5. See 84 FR 49564.
6. <https://ustr.gov/sites/default/files/enforcement/301Investigations/2018-17709.pdf>.
7. See 84 FR 49600.
8. <https://ustr.gov/sites/default/files/enforcement/301Investigations/Tariff%20List%20%2883%20FR%2047974%2C%20as%20amended%20and%20modified%20by%2083%20FR%2049153%29.pdf>.
9. See 84 FR 49591.
10. <https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-reached-agreements-japan-improve-trade-nations/>.
11. <https://www.whitehouse.gov/presidential-actions/presidential-memorandum-united-states-trade-representative/>.
12. <https://ustr.gov/sites/default/files/enforcement/301Investigations/FRN%20China301.pdf>.
13. While the USTR had requested comments on the proposed rate increase from 25% to 30% for certain tariffs with an effective date of 1 October 2019 (see 84 FR 46212), President Trump subsequently indicated the tariff increase would be delayed to 15 October 2019.
14. Stage 2: Initial Substantive Review of whether the exclusion request should be granted, based on the substantive criteria set out in the Product Exclusion Notice.
15. Stage 3: Administrability Review, based on consultations with U.S. Customs and Border Protection, the request is further reviewed to determine whether an exclusion would be administrable.
16. See CSMS # - GUIDANCE: Seventh Round of Products Excluded from Section 301 Duties (Tranche 2)
17. <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2019/september/fact-sheet-us-japan-trade-agreement>.
18. <https://www.whitehouse.gov/briefings-statements/joint-statement-united-states-japan-2/>.
19. See endnote 13.

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