# Trade Compliance

In our increasingly global economy, companies frequently find themselves operating across multiple international jurisdictions, sourcing materials and supplies from overseas, and/or exporting their own products and services to foreign purchasers. In all such cases, the need for a well-developed, structured, and tailored trade compliance program is paramount. In addition to ensuring compliance with applicable laws and regulations, companies stand to realize significant cost savings through utilization of processes and programs afforded under those laws and regulations. While this article is in no way exhaustive of all compliance considerations or potential avenues for cost savings, it is intended to provide a high-level overview of potential trade issues that a company establishing U.S. operations should consider.

## IMPORTING INTO THE UNITED STATES

Importers in the United States find themselves subjected to a myriad of laws and regulations – the extent of which is typically dictated by the commodity in question. For example, importers of children's products are subjected to the obligations of the Consumer Product Safety Act as administered by the Consumer Product Safety Commission – laws and regulations that would not apply to most imports. However, all importers are bound to comply with the Customs laws and regulations of the United States, along with other laws as may be mandated by the specific commodity.

In 1993, the United States enacted what is known as the Customs Modernization Act, or "Mod" Act, which introduced the concepts of "informed compliance" and "shared responsibility." These dual theories are premised on the idea that the trade community must be "clearly and completely informed" of legal obligations, but that the trade community shares responsibility with Customs and Border Protection (CBP) in ensuring trade compliance obligations are met. As a result, the importer is responsible for using "reasonable care" to enter, classify, and determine the value of imported merchandise and to provide any other information necessary to enable CBP to properly assess duties, collect accurate statistics, and determine whether other applicable legal requirements, if any, have been met. As a result, tort-like theories of negligence and gross negligence have been introduced, whereby an importer may face various penalties for violations involving the failure to use "reasonable care."

As noted above, the scope of applicable laws and regulations can be quite broad – depending on the particular commodity being imported. Therefore, importers must be well versed in the Customs laws and regulations, as well as the legal and regulatory requirements, if any, specifically governing the commodity they import. In addition to maintaining a well-developed and industry-specific compliance program, importers should periodically audit and perform self-assessments of their compliance programs and ensure their particular methods of operation are not creating unrecognized liabilities for violation of Customs laws and regulations. (Note, two of the most common violations are misclassification of merchandise and failure to properly calculate entered value to account for assists and statutory additions to value.)

If this article stresses any one point, it would be that trade compliance must be a corporate priority for members of the trade community, with investment from everyone in the organization – from dock workers and forklift drivers to C-suite executives.

## DUTY (TAX) AVOIDANCE, DEFERRAL, AND MITIGATION

Although the Customs laws and regulations supply a considerable number of opportunities for importers to find themselves in trouble, the same laws and regulations likewise provide a number of opportunities to lessen, defer, or avoid altogether certain duties and fees that an importer may be subjected to upon the importation of merchandise into the United States. Some examples of potential opportunities for cost savings include, but are not limited to, utilization of free trade agreements, "tariff engineering," and foreign trade zone operations – each of which are described on the following page.

**Free Trade Agreements (FTAs)**

At present, the United States has fourteen FTAs in force with twenty countries. In many instances, these FTAs provide for duty free entry of merchandise "originating" from those countries; however, what constitutes an "originating" good under any particular FTA is a matter of legal definition as supplied by the agreement itself. As such, it is necessary to have a full understanding of the FTA's provisions to ensure any preference claim can be supported. Where applicable, FTAs can permit importation of merchandise with a considerable duty savings (or potentially avoidance altogether). As such, importers may wish to consider possible application of various FTAs when developing supply chains.

**Tariff Engineering**

The term "tariff engineering" has been coined to describe the process by which an importer engineers a particular article of merchandise to avoid and/or fit a particular classification under the Harmonized Tariff Schedule of the U.S. (HTSUS). The result can be significantly lower duty rates, particularly in the case of textile and apparel articles (which customarily carry comparatively high tariff rates).

Among others, Columbia Sportswear has made tariff engineering quite famous with several significant cost-saving design decisions. An example is Columbia's PFG Tamiami, a popular women's garment with pockets located below the waistline. Ordinarily, women's blouses and shirts would be classified in subheading 6206.40.30, with a corresponding duty rate of 26.9%. However, if the garment has "pockets below the waist, a ribbed waistband or other means of tightening at the bottom of the garment," it is excluded from heading 6206 and is classified in subheading 6211.43.1060, with a corresponding duty rate of 16.0% - a duty savings of 10.9% *ad valorem*!

**Foreign Trade Zones (FTZs)**

First established in 1934, FTZs are secured areas under CBP supervision that are considered to be "outside the Customs territory of the United States." This means that merchandise admitted to a zone has not yet been imported or "entered" into the United States and, as a result, duties and certain fees may be deferred, mitigated, or avoided altogether.

Under an FTZ, Customs duties and taxes are due only at the time of transfer or withdrawal of the merchandise from the zone into the United States. Therefore, payment of duty is deferred until the merchandise is withdrawn from the zone, and if the merchandise never enters U.S. commerce (i.e., it is exported or destroyed), then no duties are ever paid. Moreover, there is no limit on the length of time merchandise may remain in zone. Where manufacturing in a zone is permitted, importers/manufacturers may benefit from the "inverted duty" concept – whereby a finished product may take advantage of a lower duty rate than its component parts and duty is not assessed on labor, overhead, or profit attributable to zone production operations.

The operation and management of an FTZ is a complicated endeavor and can carry considerable start-up and operational costs. While zone operations may not make fiscal sense for every importer/manufacturer, they can confer considerable cost savings in the correct scenario.

## PREPARATION IS KEY

Implementing a well-developed, structured, and tailored trade compliance program is essential for a company establishing operations in the United States. First and foremost, a company who is entering the United States needs to ensure that they will be in compliance with all applicable laws and regulations. Then a company should seek to understand the potential ways in which they can realize cost savings through utilization of processes and programs afforded under the laws and regulations. Preparation for trade compliance as you begin exploring opening a new operation in the United States is a key component of long-term success.

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