TOP 10 RECOMMENDATIONS FOR CUSTOMS PLANNING

The arrival of a new year and a new administration warrants a fresh-eye review of compliance procedures and processes to confirm that they are aligned with current supply chain strategy and can effectively support evolving business needs along with growth and change. Notably, the growing share of customs duties as a percentage of the cost of goods sold has an increasing impact on earnings as above-the-line cash costs. This presents a unique challenge to businesses attempting to manage the effects of these changes on current operating structures and/or when valuing business divestitures. Annual risk assessment procedures may help highlight opportunities for improvement.

Whatever the starting point, some areas merit attention regardless of industry or company size. The following recommendations will help to positively impact import and export compliance outcomes.

1

CUSTOMS VALUATION

The customs value declared on imported goods represents the taxable basis on which duties and import taxes are calculated. Important differences exist between customs valuation rules and transfer pricing rules, which often produce a "whipsaw effect" – as one increases, the other decreases. Addressing these two areas in tandem yields significant benefits and provides an opportunity to manage total tax liability globally and on a country-by-country basis.

Businesses should review their policies holistically so that customs valuation methods are applied consistently across geographies (accounting for local market differences). Otherwise, certain red flags may arise as a result of inconsistencies in the treatment of similar products in different markets. Additionally, transfer pricing documentation should detail the total pricing formula to support any necessary periodic adjustments and/or entry correction processes, as applicable.

A unique opportunity for customs value planning often arises in transactions that involve a middleman. The United States is the only major trading nation that still allows the use of the first sale rule (FSR) whereby the original factory invoice price serves as the customs value when it represents the first in a series of two or more sales preceding importation into the U.S. However, businesses should confirm that there is sufficient documentation to support the **three-factor test for FSR claims**:

1. **Bonafide sale**
2. **Sale for export clearly destined to the U.S**
3. **Arm's-length price**

Importers should evaluate negative factors that could cause an earlier transaction to be disregarded under U.S. Customs and Border Protection's (CBP's) rules.

2

IMPORT & EXPORT CLASSIFICATION

The U.S. import tariff classification number (usually the same as the Schedule B number for goods exported from the U.S.) determines the applicable duty rate for imported goods and other additional regulatory controls that apply to certain classes of imported merchandise. In addition to the Schedule B number, the Export Control Classification Number (ECCN) determines jurisdiction and specific responsibilities under the Export Administration Regulations (EAR), including licensing obligations and country restrictions that may apply. To appropriately apply the Harmonized Tariff Schedule of the U.S. (HTSUS) code, the Schedule B number or the ECCN, a detailed review of an article's composition, and technical specifications are required. Such data can include wattage or voltage for electrical items or fabric content for textiles and apparel. How the merchandise is used may play a critical role. Product experts, like design and development engineers, are often involved in the process.

In order to apply the complex rules in play, businesses must first understand them. Assigning correct tariff codes (and corresponding duty rates for imports) will correctly calculate the landed cost for the buyer or seller. Businesses should be able to identify duty refund opportunities and potential future savings when goods have been previously misclassified. For exported goods, proper Schedule B/HTSUS and ECCN classification is necessary to determine the specific controls applicable to each transaction, including country restrictions and licensing requirements or exceptions.

3

COUNTRY OF ORIGIN

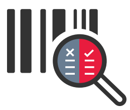
The country of origin of imported goods may impact eligibility for free trade programs, admissibility, quota, marking and labeling requirements, and government procurement provisions. Moreover, the rules of origin are product-specific and can vary under different trade preference programs.

Products subject to disparate manufacturing processes occurring across multiple country borders may warrant scrutiny to confirm that production processes confer origin. For example, simple assembly of foreign-made components does not confer origin in the country of assembly. In order to support the desired origin outcome, it is critical to pay close attention to and thoroughly understand CBP's substantial transformation test.

Businesses should carefully monitor and document processes related to qualifying goods under the Buy American Act, which requires that federal government agencies buy goods "substantially made" in the U.S. Waivers may be obtained via CBP ruling requests, but all outcomes hinge on a proper understanding of the rules and their applicability in specific scenarios.

4

DUTY DRAWBACK AND OTHER RELIEF

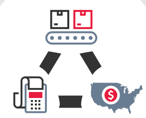


Exports of previously imported products may qualify for duty relief under CBP's duty drawback program, whereby a refund of 99% of any duties paid can be reclaimed as either "unused merchandise drawback" (the same item is exported as was imported) or as "manufacturing drawback" (imported materials that are further processed prior to export). Under certain conditions, items scrapped or substituted with domestic materials may also qualify for duty drawback.

Trade preference programs often provide an opportunity for duty suspension or relief on qualified product imports. For example, the United States-Mexico-Canada Agreement (USMCA) allows duty-free entry into each member country, but only if the specific rule of origin corresponding to the tariff code of the exported good is met. Businesses should assess these rules and document support for duty relief or suspension claims.

5

TRADE REMEDIES



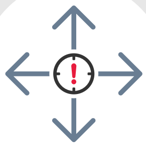
Antidumping duties (ADD) and countervailing duties (CVD) are widely used trade remedies that target unfair foreign trade practices which distort pricing and injure (or threaten to injure) U.S. businesses. These measures target sales priced below the cost of production or that benefit from foreign government subsidies. Collection of supplemental tariffs is one of CBP's top-priority trade issues.

Other additional tariffs under U.S. Section 201 and Section 301 of the Trade Act of 1974 and Section 232 of the Trade Expansion Act of 1962 may also apply. Some imported products are impacted by multiple trade remedies, effectively stacking the duties owed.

At times, importers are made aware of these measures after product importation when it is too late to renegotiate pricing with the vendor. Before placing a purchase order, businesses should determine whether imported products are subject to trade remedies and assess alternatives to manage exposure, such as sourcing from another country or, for ADD and CVD duties, filing a scope ruling request with the Commerce Department prior to importation.

6

EXPORT CONTROLS



Among major trading nations, the U.S. stands out as having strict export controls with additional extraterritorial scope. Because multiple U.S. government agencies regulate U.S. exports, it is imperative businesses understand the correct ECCN classification of goods, including technology, and the appropriate export control jurisdiction to help determine effective controls. By integrating export and sanctions compliance requirements into the overall compliance program, businesses, including scientific and academic institutions, can avoid inadvertent export violations. In order to prevent violations, it is critical to communicate the importance of compliance and assign responsibilities to internal stakeholders whose activities touch upon exporter responsibilities.

U.S. businesses are responsible for knowing their customers and implementing effective controls to prevent exports for prohibited end-use or end-users. The U.S. Bureau of Industry and Security (BIS) has issued **Know Your Customer Guidance** that documents real penalty cases and provides useful tools and tips for evaluating customers and identifying potential red flags or other indicators where regulated products may go to a prohibited end-use or end-user.

Effective controls and common checks include:

- Background checks of company officers and known affiliations to restricted entities.
- Statement from the end-user indicating how the goods will be used.
- Export control language included in contracts to delineate compliance responsibility under the EAR and the International Traffic in Arms Regulations (ITAR).

7

REASONABLE CARE

Companies should have internal stakeholders who understand and proactively drive their compliance programs to respond quickly and effectively to changes in the business environment. Often, these responsibilities are managed under a chief financial officer, tax director, controller or legal department that work to understand and legally minimize risks through careful planning and analysis.

The Customs Modernization Act of 1993 places responsibility on the importer to use reasonable care to enter, classify and determine the value of imported goods and to provide information necessary CBP to collect duties and determine other applicable for requirements.

Importers now must verify throughout the supply chain that no "forced labor" is used in producing any U.S.-bound merchandise, especially in the Xinjiang region of China. The applicable statute prohibits the use of forced labor for any products from any countries, and with the Biden administration's focus on a worker-based trade policy, CBP has made enforcement a priority in 2021 and beyond. Goods suspected of being made with forced labor are detained at the U.S. port of entry until the importer provides evidence that the goods were not made with forced labor.

BIS has published industry guidance to assist businesses in complying with their obligations under the EAR, including for:

- Red-flag indicators
- Due diligence regarding suspicious circumstances and appropriate end-use, end-user or ultimate country of destination
- A duty not to self-blind
- A duty to refrain from transactions

Additionally, the Directorate of Defense Trade Controls has published compliance program guidelines to assist U.S. companies in complying with their obligations under the ITAR.

8

THIRD-PARTY OVERSIGHT AND SUPERVISION

Businesses often rely on third parties, such as freight forwarders and customs brokers, to manage import and export formalities in connection with their cross-border tangible goods transactions. Under those circumstances, a compliance framework, including written instructions to clarify expectations and detailed metrics, is a critical success factor.

Businesses should pay careful attention to CBP's importer rules, which place the onus for compliance on the importer, and to supplier terms and conditions that limit businesses exposure to the fees paid. Mistakes and omissions can often far exceed the set limits on liability. Businesses should perform additional checks to confirm that procedures are being followed and to validate filings.

9

COMPLIANCE ASSESSMENTS

Businesses should gauge the effectiveness of import and export compliance procedures and processes regularly to confirm they are staying up to date with and appropriately implementing changes. An import/export compliance assessment delivers valuable insight to help businesses proactively identify risks and gaps in real time and offers an opportunity to implement additional safeguards to to mitigate risk. Risk assessments can inform internal prioritization of current efforts and highlight duty and other cash savings and refund opportunities.

U.S. importers and exporters should review government filings to confirm the accuracy of information reported and correct any errors. Businesses can obtain reports of import and export filings via CBP's **Automated Commercial Environment (ACE) portal**.

Importers should also carefully examine any free trade agreement claims, given that they are usually based on documentation and certifications provided by the seller/vendor. The U.S. importer of record is liable if later CBP verifications reveal those claims to be invalid. Proactively assessing claims (under the USMCA, Generalized System of Preferences, U.S.-Korea Free Trade Agreement, etc.) brings peace of mind to importers of duty-free merchandise that would otherwise be dutiable absent the free trade agreement claim.

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KNOWLEDGE MANAGEMENT

Training and broad stakeholder awareness and engagement is essential to effective import and export compliance programs. Training curricula should be tailored to the specific organization's activities, risks and processes to promote stakeholder understanding of the applicable import/export requirements and how their roles contribute to the overall compliance strategy.

Businesses should assess internal capabilities, manage shortcomings, perform succession planning and commit to hiring, developing and retaining competent employees.

Internal communication of compliance policies and procedures can promote an understanding of the applicable requirements and effectively reduce the risk of non-compliance. One of the most common misconceptions is that compliance work is performed by the compliance department, whereas in practice, businesses consist of complicated interdisciplinary webs of people and processes that touch on specific compliance requirements and importer and exporter obligations.

Often overlooked (especially in the export controls arena) is the fact that the government may sanction individual employees – not just the company or corporate officers—with both civil and criminal penalties. Awareness, understanding and continuing education are the keys to avoid such scenarios.

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HOW BDO CAN HELP

BDO provides cost-effective support in all aspects of international trade strategy, planning and compliance by focusing on the "customs triangle" of tariff classification, customs valuation and country of origin to help businesses minimize risk and exposure. Equally as important, we help companies minimize their global duty spend and secure duty refunds and future savings, where available. Duties are "above the line" and represent a permanent new cash flow when duty mitigation strategies are successfully implemented.

For more information, please reach out to BDO's Customs and International Trade Services team for further guidance and information:

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