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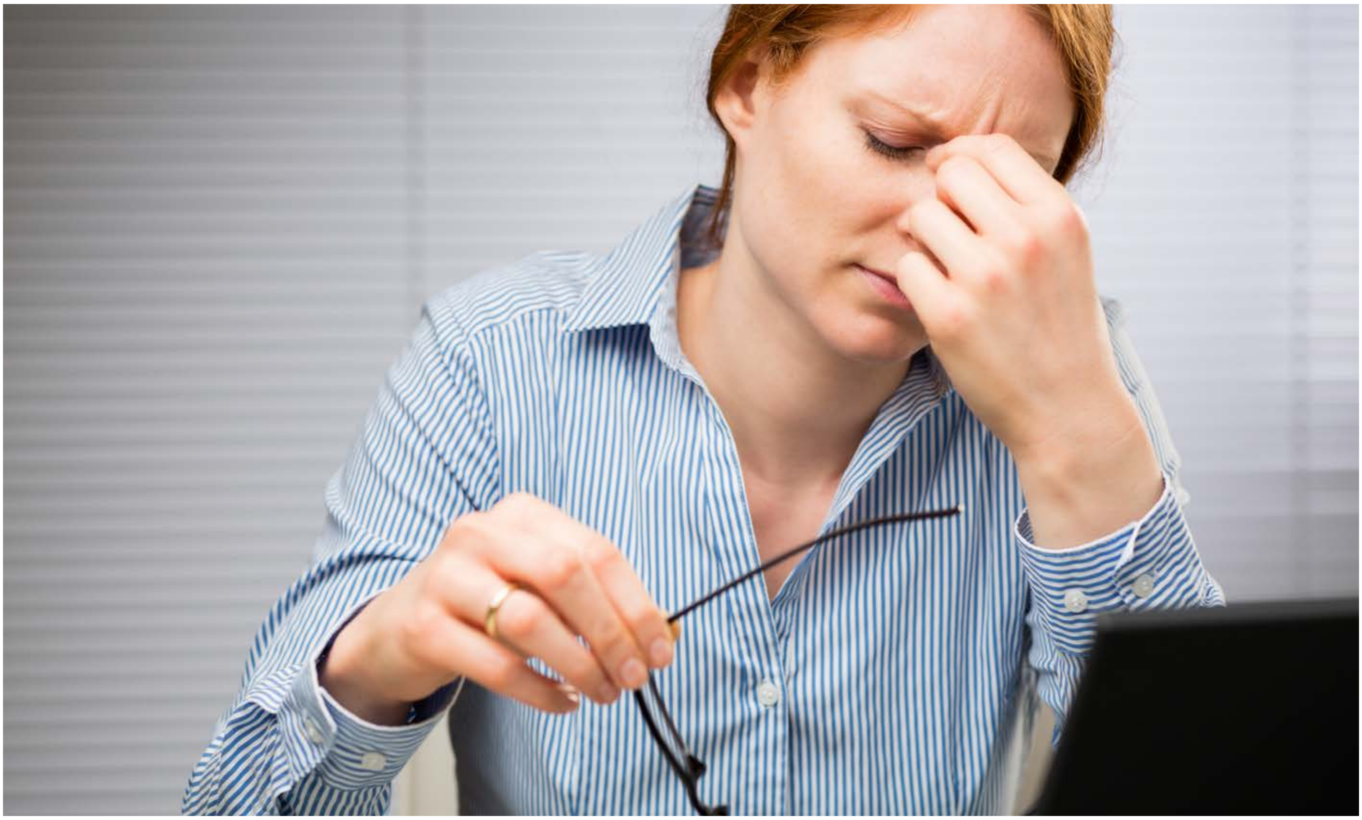

Free trade agreements create compliance headaches

Free trade agreements potentially offer significant cost savings to companies by opening up market access between signatory countries and reducing barriers to trade, but managed ineffectively they also pose huge compliance risks. **Jaclyn Jaeger** asks trade compliance professionals what risks they face and how to avoid them.

The overall concept is simple enough: Free Trade Agreements (FTAs) open up market access between signatory countries by reducing barriers to trade. The reduction of trade barriers—such as custom duties—effectively makes it easier and more cost effective for U.S. companies to export their products and services to trading partner markets.

"The benefit to taking advantage of a free trade agreement is not only market access, but if your products qualify for reduced-duty or duty-free treatment, that will translate into lower-landed costs for the company's imports into those countries," explains Richard Mojica, who focuses on international trade and customs compliance counseling at law firm Miller & Chevalier. "With this benefit comes the compliance challenges."

For many trade compliance professionals, the most complex challenge posed by FTAs is understanding and navigating the various "rules of origin," which are highly complex and technical rules that describe how exported goods shipped to a country, or a region, may qualify for duty-free or reduced-duty benefits under the applicable trade agreement.

Take the so-called "yarn forward" rule of origin as just one example. As a key component of the controversial Trans-Pacific Partnership (TPP)—a U.S.-led trade agreement involving twelve countries that's currently under negotiation—the "yarn forward" rule would require that only fabric produced from yarn made by a TPP country would qualify for the trade agreement's duty-free status.

Now consider that each FTA can include hundreds upon hundreds of similar and restrictive rules of origin. With over 400 trade agreements currently in force, FTA compliance becomes an arduous task, to say the least, for any company that manufactures potentially thousands of goods across multiple markets.

To qualify for preferential treatment under a free trade agreement, a product must satisfy a certain rule of origin. Those rules of origin are FTA-and product-specific and generally require a careful analysis of the component makeup, country of origin, and tariff classification of each component that goes into the product at issue. "If that sounds complicated, that's because it is," Mojica says. "Learning how to navigate rules of origin is the key to benefitting from free trade agreements."

To claim or not to claim?

Many trade executives agree that conducting a risk-reward analysis is imperative to deciding whether to claim trade preference at all. That analysis could take into consideration resources, reliability of data, risk, application of one preference over another, and consideration of alternatives, Michael Heldebrand, a member of the global trade practice at EY, said during a recent webinar on global trade management. "The bottom line is that preference trade approach should be clearly and intentionally set," he said.

Once companies have made that decision, managing the compliance hurdles that come along with FTAs becomes the next step. "Companies are actively managing preferences by assigning resources (both internal and external), leveraging centers of excellence or shared service centers, analyzing gaps in missing or potentially incorrect information or documents, evaluating what additional opportunities could be reached, and communicating with corporate stakeholders," according to EY's 2016 Global Trade Symposium report.

Leveraging synergies among people and information was a key finding in EY's report. Thirty-eight percent said they assign dedicated internal resources to undertake preferential agreement work, and 33 percent said they use third parties to assist in the processes. Outsourced activities included "doing the operations work," "soliciting suppliers," "getting [vendor] certificates," and "qualification analyses," according to EY's report.

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> Richard Mojica, Counsel, Miller & Chevalier

Most all trade professionals reported having at least one full-time equivalent (FTE) assigned to global strategy and planning, including preference agreement activities. The type of strategic analyses undertaken by these personnel often include:

- Analyzing opportunities against corporate footprint—such as looking at the company's long-term strategy and where it wants to be
- Being actively involved in lobbying around FTA negotiations to ensure their interests are being considered by trade negotiators
- Working with cross-functional corporate teams on target markets to inform the business of FTA qualification requirements as part of the manufacturing/vendor/supply chain strategy for new production locations

According to the EY report, the overall consensus of executives was that these strategic activities are having a big impact on the financial results of their companies, and they expect the emphasis on this area to grow.

Vendor management

Under some free trade agreements, companies must certify with a Certificate of Origin completed by the exporter that products are eligible for preferential treatment under the rules of origin. The burden of proving the Certificate of Origin historically has been on the exporter, but the importer is required to exercise reasonable care that the certificate is valid.

Therein lurks another common compliance pitfall: ven-

NAFTA CERTIFICATE OF ORIGIN FAQS

Below is a partial list of Frequently Asked Questions about the NAFTA Certificate of Origin.

Do I need to complete the NAFTA Certificate of Origin to export my product to one of the other NAFTA countries?

The NAFTA Certificate of Origin is not required for shipments to another NAFTA country unless the product qualifies for preferential tariff treatment under the NAFTA rules of origin. A certificate is not needed if the shipment does not qualify for preferential tariff treatment.

How do I determine where my good is classified?

Products are classified using national tariff schedules of the country into which they are imported. All NAFTA countries are members of the World Customs Organization (WCO) and utilize the Harmonized Commodity Description and Coding System. The system is used by more than 200 countries and economies as a basis for their Customs tariffs and for the collection of international trade statistics.

The Harmonized System comprises about 5,000 commodity groups. Goods are classified under a six digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification.

The first two digits are the chapter, the first four comprise the heading, and the first six digits comprise the subheading. For example, a grand piano is classified in subheading 9201.20 of the Harmonized System. Chapter 92 is used for Musical Instruments; heading 92.01 for pianos, and subheading 9201.20 is for grand pianos. Individual countries may establish additional classifications beyond the six-digit level. At the eight-digit level these are called tariff items.

What language should be used to complete the NAFTA Certificate of Origin?

A uniform Certificate of Origin is used in all three countries and is printed in English, French or Spanish. The Certificate shall be completed in the language of the country of export or the language of the importing country, at the exporter's discretion. Importers must submit a translation of the Certificate to their own customs administration when requested.

Who is responsible for determining if the product qualifies under NAFTA and for completing the certificate?

The Certificate of Origin must be completed and signed by the exporter of the goods. Where the exporter is not the producer, the exporter may complete the Certificate on the basis of: knowledge that the good originates; reasonable reliance on the producer's written representation that the good originates; or, a completed and signed Certificate of Origin for the good voluntarily provided to the exporter by the producer.

Exporters who are not producers often request that their producers or distributors provide them with a NAFTA Certificate of Origin as proof that the final good, or an input used in the manufacture of the final good, sold to Mexico or Canada meets the rules of origin. NAFTA does not obligate a producer who is not an exporter to provide the ultimate exporter with a NAFTA Certificate of Origin. However, if the non-exporting producer does complete the NAFTA Certificate of Origin, they are subject to the same obligations regarding record-keeping and other obligations as is the exporter. Even so, it is the exporter's Certificate, and not the non-exporting producer's Certificate, that must be provided to the importer. The producer's statement should be kept in the files of the exporter as backup for their own Certificate.

Source: Office of the U.S. Trade Representative dor relationships and education. "A lot of companies don't really understand how these free trade agreements work, so often times they will sign a certificate saying their goods qualify for a free trade agreement when they really don't," says Adrienne Braumiller, founder of the Braumiller Law Group, an international trade law practice.

Under the rules of the NAFTA Certificate of Origin, for example, exporters cannot certify that a product qualifies for preferential treatment just because they purchased it from a warehouse in North America. Only if *all* of a product's component parts were made in NAFTA territory—the United States, Mexico, and Canada—can the product then be certified. Rather, to qualify as NAFTA-eligible, the product must satisfy the applicable NAFTA rule of origin, which generally will require a tariff classification analysis, a regional value-content analysis, or both. If the product qualifies for preferential treatment under NAFTA, exporters must prepare certificates of origin. "If a company does not prepare and retain certificates of origin as required by a particular free trade agreement, it could be subject fines and penalties from customs administrations around the world," Mojica explains.

According to EY's *2016 Global Trade Symposium report*, many trade executives said they do not take at face value a determination made by their suppliers. Many trade executives also said they take a deeper dive into goods that suppliers originally indicated as not qualifying under particular FTAs.

For importers that rely on exporters to prepare the information needed to claim a certain trade benefit, "the best thing you can do is give yourself the ability to audit their records and do your own evaluation," Braumiller says. "You can also ask them to indemnify you in case the goods are determined not to qualify, so there are contractual things you can do to protect yourself."

People, processes, technology

Beyond vendor dependency, many trade executives use "centers of excellence"—cross-functional engagement of key stakeholders—to improve classification and reduce duplicate efforts, including requests to vendors. "A need for advanced planning and coordination with other departments is essential," Heldebrand said. Whereas trade or compliance executives traditionally relied on procurement or sourcing to provide information, there is now a push to be involved in some of those initial discussions with procurement and sourcing, he said.

Many trade executives also agree that classification skills for their companies' products require special technical skills—such as chemical engineers, mechanical engineers, or software engineers—in addition to customs and trade skills.

Having written trade compliance procedures in place can also be helpful, Braumiller says. Those procedures may describe when the company should solicit information from its suppliers, how it's done, where records are kept, and how supplier information is reviewed to ensure it is complete and accurate, she says.

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Adrienne Braumiller, Founder, Braumiller Law Group

For many companies, automation is increasingly replacing time-consuming manual efforts concerning trade management exercises. Global trade management software providers like Amber Road offer import, export, and duty management solutions, which enable customs teams to centralize their product classification process and streamline their supplier solicitation efforts.

Amber Road's global product classification features, for example, help to properly classify products based on the relevant country of import and country of export while also documenting all decision criteria to support future audits, and the configurability of the system allows the customs department to determine the level of user access. To be able to automate trade management for all the countries you're doing business in with one piece of software is really valuable, notes Ty Bordner, vice president of solutions consulting at Amber Road.

The message overall in an ever-evolving and ever-more complex global trade market is that trade professionals have a very valuable and strategic role to play to enable corporate growth. "Failure to appreciate that dynamic, on the other hand, can really inhibit growth," said Kristine Price Dozier, a member of EY's customs and international trade practice. "The tasks are challenging, but the contribution overall is very significant." ■