US, Korea Get Tough on Verifying Compliance with FTA Claims

SJ Guest Editorial

The U.S. and South Korea presidents met privately in Seoul last month to address concerns about the level of enforcement by customs authorities on exporters there. According to Korean press reports, President Obama carried with him the message that U.S. exporters are upset at the increased scrutiny of their benefits and claims by the Korean Customs Service (KCS) under the U.S.-Korea Free Trade Agreement (UKFTA, also known as KORUS).

The heightened scrutiny of claims for preferential treatment under the U.S.-Korea FTA has come in the form of excessive demands for documentation and on-site visits to suppliers several steps down the supply chain. While these measures are not outside the bounds of the agreement and the concerns about them are therefore not likely to result in any changes to it, authorities may amend their procedures to ease the burden on affected companies. Importers and brokers should continue to monitor this issue for what will likely be additional developments.

Hailed as the United States' most commercially significant free trade agreement since the North American Free Trade Agreement was enacted nearly two decades earlier, the UKFTA took effect March 15, 2012. Tariffs on almost 80% of two-way trade in consumer and industrial products were eliminated as of that date, and another 15% of these goods will become duty-free by Jan. 1, 2016. A few tariffs will remain in place until 2026. Tariffs not immediately eliminated will mostly be phased out in equal annual stages over periods of up to 15 years.

With respect to textiles and apparel, the UKFTA incorporates a yarn-forward rule of origin, which (with very limited exceptions) only allows duty-free treatment for goods if yarn production, fabric production, and cutting and sewing all occur within the U.S. or Korea. This rule is generally supported by U.S. textile manufacturers because they believe it increases demand for their goods, while the U.S. apparel industry does not favor the rule because it largely precludes the possibility of more flexible sourcing of components from lower-cost producers. Most U.S. exports of textile and apparel products to Korea were eligible for duty-free treatment soon after the agreement was implemented, while the elimination of U.S. tariffs on such goods from Korea will take five to ten years, depending on the type of product.

Most U.S. textile and apparel exports and imports to and from Korea (by value) are now duty-free or nearly so. Duties have been eliminated for 82.2% of apparel imports and will be dropped for another 8.9% by March 1, 2016. The average base tariff for U.S. apparel imports from Korea has dropped from 11.6% in 2012 to 0.6% for HTS Chapter 61 and from 10.1% to 0.3% for Chapter 62. For textile imports, however, only 49.0% are no longer subject to tariffs, with the remainder being eliminated as of March 1, 2016 (20.9%) and then March 1, 2012 (30.1%). For U.S. textile exports to Korea, duties have been dropped for 92% of shipments and the rest (covering chapters 39, 50, 54, 55, 56, 59 and 70) will go to zero as of March 1, 2016. Korea eliminated all tariffs on U.S. apparel exports as soon as the agreement took effect.

Nevertheless, the UKFTA has thus far had little impact on the volume of trade in textile and apparel goods between the two countries. U.S. imports actually dropped to $920.1 million in 2013 from $925.1 million in 2012 and saw a similar decline from $926.5 million to $920.4 million for the 12-month period ending in February 2014 compared to a year earlier. Imports of textiles totaled $686.3 million, compared to $233.8 million for apparel. On the export side, shipments were up 5.8% in 2013 to $386.8 million and 6.1% to $391.5 million for the year ending in February.

Even so, the volume of existing textile and apparel trade and the benefits of the UKFTA, particularly given the

proximity of Chinese inputs to Korean factories, have officials on both sides on alert for signs of malfeasance. Areas of particular concern include insufficient documentation of the origin of materials claimed as originating, inability to distinguish originating and non-originating materials due to commingling, classification errors leading to a failure to satisfy the tariff shift rules, and a lack of support to show the regional value content requirement has been met.

In the U.S., ports of entry are given wide latitude to determine the type and extent of the reviews they conduct to determine the validity of claims of duty-free treatment, and importers must be ready to substantiate those claims using certifications or other documentation or their specific knowledge. While there is no specific format mandated by U.S. Customs and Border Protection for a certificate of origin, there are certain required fields, including the importer, exporter and producer; the name of the certifying person; the good's tariff number and description; and information demonstrating that the good is originating. Certificates of origin must be in the importer's possession at the time a preference claim based on such a certificate is made, but no certificate is required for claims based on the importer's knowledge (though such claims are often subject to particular scrutiny).

Claim verifications by CBP can take a number of forms. A written request for information (CF 28) may be submitted to the importer, exporter or producer seeking details such as flow charts or technical specifications outlining the manufacturing process, an explanation of how the goods originate, purchase orders and proof of payment, documentation relating to assists and indirect materials, or just about anything else that might be relevant. CBP officials may visit the exporter or producer in Korea to review records and/or observe production facilities, or they may request that the KCS conduct an origin verification. Other methods may be used as well.

CBP will then issue a CF 29 outlining the action taken, if the verification was positive, or the action proposed, if the verification was negative. In the latter instance, the CF 29 will explain why the documentation was insufficient or why the good otherwise does not originate, and the importer will be given 20 days to respond. Ultimately the importer will likely be liable for the payment of duties and fees, though it retains the ability to challenge any such determination via administrative protest for 180 days past the date of liquidation.

Verifications conducted by KCS have a different focus, as this agency is typically not satisfied with responses or documentation from producers. For example, in an automotive production chain in which the manufacturer receives components from a Tier 1 supplier, which may have received components from a Tier 2 supplier, and so on, KCS has requested information and documentation from as far down the chain as Tier 3 suppliers. (CBP, by comparison, has historically focused on Tier 1 suppliers, provided there are certificates or affidavits present throughout the chain.) This approach has yielded complaints that KCS' demands for origin certification are excessive.

Proper preparation can help importers avoid interruptions to their operations from a CBP or KCS verification. Start by creating a reasonable process to document preference claims; e.g., ensuring that suppliers are contractually obligated to provide required documentation and then testing to make sure it is present. Perform due diligence prior to making claims, such as by reviewing all claims where the value content is below a certain threshold and periodically reviewing all others. Train affected staff so proper procedures are followed.

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