Your Mexican Maquiladora Facility: Important Considerations for U.S. Trade Compliance Personnel

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Today’s Agenda

- Mexico Maquiladora Law Changes
- Role of the Customs Broker in Mexico
- U.S. Compliance Considerations for Maquiladoras
  - NAFTA
  - 9801 and 9802
  - Declared Value
Changes to Maquiladora Law
Key Terms

- SAT – Mexican Tax Authorities (IRS equivalent)
- IMMEX – Promotion of the Manufacturing, Maquila and Export Service Industry
  - The IMMEX Program is an instrument which allows the temporary importation of goods that are used in an industrial process or service to produce, transform or repair foreign goods imported temporarily for subsequent export or provision of export services, without covering the payment of general import tax, value added tax and, where appropriate, countervailing duties.
- VAT – Value Added Tax
  - A type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale. The amount of value-added tax that the user pays is the cost of the product, less any of the costs of materials used in the product that have already been taxed.
- Annex 24 – Inventory management system maintained by IMMEX compliant companies to track temporary imports.
- Annex 31 – New inventory reporting requirement for VAT certified companies.
Tax Reform has changed rules for the IMMEX industry

- Dec 11, 2013 - Tax reform is officially enacted as it is published in official legal gazette.
  - VAT law is drastically amended for temporary imports at IMMEX companies, as well as automotive and trucking OEMs operating under fiscal deposit.

- Stated Reasons for Reform
  - Public Justification: The lack of compliance with customs regulations by IMMEX and OEM companies handling temporary imports.
  - Practical Reason: A need for revenue and financing of budget for Mexican Government.
Tax Reform has changed rules for the IMMEX industry

- Elimination of the exemption on VAT for temporary imports.
- Implementation of a standard 16% VAT rate for entire country, as the former “border” rate of 11% was also eliminated.
- All temporary imports and the so-called “virtual transactions” among IMMEX companies were impacted. (became effective Jan 1, 2015)
- Sales between non-residents in Mexico and IMMEX or Automotive OEMs impacted by VAT after the reform. (became effective Jan 1, 2014)
VAT Certification

- Available to Companies that demonstrate a requisite level of compliance in tax and trade compliance are eligible to receive this certification by the SAT.

Three levels of certification:

- The SAT certification is available in three categories, “A,” “AA,” and “AAA,” each providing a higher level of benefits, while at the same time an increased number of requirements.
VAT Certification

- **“A” Certification Requirements**
  - Maintain adequate inventory controls to track imported goods and raw materials.
  - Obtain a positive tax compliance opinion issued by the Mexican tax authorities at least 30 days prior to application.
  - Not be listed on the Mexican tax authorities’ (SAT) website as a “noncompliant taxpayer.”
  - Have valid “digital seals.”
  - Demonstrate that all personnel are registered with the Social Security Institute (IMSS) and provide documents showing payment of social security for at least 10 employees.
  - Produce evidence of financial investment in Mexico.
  - **Submit the name and address of customers and suppliers abroad.**
  - Allow custom officials to carry out an initial inspection and any additional inspections, as needed.
Higher Categories

“AA” Certification Requirements

- All of the requirements for obtaining “A” certification.
- At least 40% of the maquiladoras operations in Mexico in the previous year are with suppliers that have a positive tax compliance opinion.
- The IMMEX maquiladora operations have been carried out for at least 5 years, or the company had more than 1,000 employees registered with IMSS in the previous year, or the value of Machinery and Equipment (M&E) at the company is greater than MXP 50 million.
- A tax liability determination had not been assessed in the 12 months prior to application.
- A VAT refund request was not denied within the previous 12 months.
Higher Categories

“AAA” Certification Requirements

- All of the requirements for obtaining “AA” certification.
- At least 70% of the maquiladoras operations in Mexico in the previous year are with suppliers that have a positive tax compliance opinion.
- The IMMEX maquiladora operations have been carried out for at least 7 years, or the company had more than 2,500 employees registered with IMSS in the previous year, or the value of M&E at the company is greater than MXP 100 million.
- A tax liability determination had not been assessed in the 24 months prior to application.
- A VAT refund request was not denied for more than 20% of the total VAT solicited within the previous 12 months.
What are the main benefits:

“A” Certification Benefits

- Immediate credit for VAT on temporary imports.
- Obtain a VAT refund within 20 business days from request date.
- Certification will be valid for one year. Renewal possible with continued compliance and by filing notice of renewal prior to expiration of certification.
What are the main benefits:

“AA” Certification Benefits

- Immediate credit for VAT on temporary imports.
- Obtain a VAT refund within 15 business days from request date.
- Thirty days for correction of any irregularities in information provided.
- Certification will be valid for two years. Renewal is automatic with continued compliance and by filing notice of renewal prior to expiration of certification.
What are the main benefits:

“AAA” Certification Benefits

- Immediate credit for VAT on temporary imports.
- Obtain a VAT refund within 10 business days from request date.
- Sixty days for correction of any irregularities in information provided.
- If any tax liability has been omitted, the customs authorities can send the maquiladora an “invitation letter” rather than initiate an automatic examination.
- Allowed to file consolidated pedimentos (customs filings) on a monthly basis.
- Export customs clearance from their tax domicile.
- Certification will be valid for three years. Renewal is automatic with continued compliance and by filing notice of renewal prior to expiration of certification.

- DON’T LOSE FOCUS OF MAIN PURPOSE OF VAT CERTIFICATION
Cancelation of the VAT Certifications May Occur If…

- Non-compliance with specific requirements for the authorized category.
- Auditing and supervisory access to SAT personnel is limited.
- Proper documentation is not kept when temporary goods are returned abroad.
- SAT personnel detect missing merchandise in the IMMEX domicile.
- Company does not produce evidence to demonstrate legal status of goods imported for more than $100,000.00 pesos.
- Pending or unpaid payments of tax credits remain unresolved.
Annex 31 Requirement

- IMMEX Companies must electronically transmit to SAT their initial inventory of temporary imports of raw materials and assets within the first 30 calendar days of January 2015. The closing date of the initial inventory must be December 31, 2014.

- SAT published Bulletin P009 allowing those companies that submitted initial Annex 31 inventory on time to subsequently correct their submission up to twice in three month period.

- SAT published Bulletin P010 providing an extension for submission of the initial Annex 31 inventory until February 28, 2015.
Impact of Changes

- Transparency for U.S. cost submission for computed value. (Both U.S. and Mexican authorities now have more visibility to inventory management)
- Increased scrutiny on Mexican suppliers and business partners. Additional stipulations in supplier contracts, leading to reconsideration of supply chain.
- Increased scrutiny on financial reporting.
- DON’T LOSE FOCUS OF MAIN PURPOSE OF VAT CERTIFICATION
Role of the Customs Broker in Mexico
Role of the Customs Broker

- In the U.S.
  - The Customs Broker must exercise Reasonable Care in all declarations to U.S. Customs on behalf of the Company.
  - Must have knowledge of all Customs Law requirements, must comply with all Customs Laws and regulations, and must keep all records related to import transactions.
  - BUT the importer of record, and NOT the customs broker is primarily legally responsible to ensure that all information provided on Customs declarations is accurate.
  - While penalties do exist for Custom Broker errors and omissions, these types of penalties are rare. With an exception for Fraud, Customs Brokers would not be found criminally responsible for errors or omissions.
Role of the Customs Broker

- In Mexico
  - Broker viewed traditionally as an advisor, in addition to role processing shipments.
  - There are several limitations on who can act as a customs broker in Mexico (e.g., national origin of broker, Mexican company, limited licensing)
  - Heightened level of scrutiny and liability associated with this privilege.
    - Intense Auditing
    - Broker Penalties
    - Possible Criminal Liability
  - Heightened scrutiny, coupled with lack of oversight by Maquiladora and U.S. Company results in actions taken by the broker that may be against the best interest of the Company.
Role of the Customs Broker

- Improving Mexican Broker Relationship

  - Develop a broker manual that reflects the best practices and procedures of U.S. trade compliance team.

  - Ensure broker relationship with Maquiladora is documented through a contract that includes:

    - Clarification on final decision making authority with respect to tariff classification, NAFTA claims, etc. (This makes updating tariff classification databases and NAFTA certificate of origin updating procedures in the U.S. crucial)

    - Process for responding to inquiries from Mexican government authorities on behalf of the Company.
U.S. Compliance Considerations for Maquiladoras
Communication – Model should be similar to U.S.

- Accounting
- Distribution Services
- Legal
- Tax
- Marketing
- Customer Service
- Purchasing
- Receiving
- Contracts
- R & D
- Regulatory
- Manufacturing
- Export
- Other
NAFTA
NAFTA Considerations

- NAFTA Certificate of Origin
  - **Importer Must Have On-Hand at Time Claim is Made.**
  - If not, Pay NTR (MFN) and NAFTA Claim May Be Made Up to 1 Year After Entry.
  - **If importer claims NAFTA without having certificate in its possession, then NAFTA claim is forever invalid.**

- NAFTA Certificate of Origin is Legal Document.

- Blanket or Per-Shipment Basis
  - Up to 1 year

- 5 year recordkeeping rule
**DEPARTMENT OF HOMELAND SECURITY**  
U.S. Customs and Border Protection  

**NORTH AMERICAN FREE TRADE AGREEMENT**  
**CERTIFICATE OF ORIGIN**  
19 CFR 191.11, 191.22

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I CERTIFY THAT:  
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- I AGREE TO MAINTAIN AND PRESENT UPON REQUEST, DOCUMENTATION NECESSARY TO SUPPORT THIS CERTIFICATE, AND TO INFORM, IN WRITING, ALL PERSONS TO WHOM THE CERTIFICATE WAS GIVEN OF ANY CHANGES THAT COULD AFFECT THE ACCURACY OR VALIDITY OF THIS CERTIFICATE;  
- THE GOODS ORIGINATED IN THE TERRITORY OF ONE OR MORE OF THE PARTIES, AND COMPLY WITH THE ORIGIN REQUIREMENTS SPECIFIED FOR THOSE GOODS IN THE NORTH AMERICAN FREE TRADE AGREEMENT AND UNLESS SPECIFICALLY EXEMPTED IN ARTICLE 411 OR ANNEX 401, THERE HAS BEEN NO FURTHER PRODUCTION OR ANY OTHER OPERATION OUTSIDE THE TERRITORIES OF THE PARTIES; AND  
- THIS CERTIFICATE CONSISTS OF [ ] PAGES, INCLUDING ALL ATTACHMENTS.

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NAFTA Considerations (cont.)

- Frequent errors
  - Failure to include tax ID in field 1
  - Failure to write correct date in field 3
  - Blanket date is for more than 1 year
  - Unreasonable preference criteria in field 7
  - Date in field 11 post-dates date of NAFTA claim
  - No signature on the NAFTA certificate of origin
NAFTA Origin

- **3 Basic Rules of Origin**
  - A. Wholly Obtained or Produced
  - B. Annex 401 Test
    - Tariff Shift and/or Regional Value Content (RVC) Rule
  - C. Made Exclusively of Originating Materials

- **Sufficient to Meet Any 1 of 3 Tests**

- **Careful!** Origin ≠ Purchased in North America
  - Origin = producer/supplier documents origin via NAFTA Certificate of Origin or Other Written Document
De Minimis Rule

Basic concept:

- If you only have a “few” raw materials that fail to undergo the tariff shift, the tariff shift requirements may be excused.

- How much is a “few”?
  
  • If total value of all non-NAFTA materials that fail to shift is less than 7% of the transaction value of the good or not more than 7% of the total cost of the good.

- Some exceptions exist for textile and other products.
9801 & 9802 Considerations

- HTSUS 9801 – U.S. Goods Returned (19 C.F.R. §10.1)
  - U.S. origin goods qualify for duty free importation if:
    - Exported from the U.S. and returned without having been advanced in value or improved in condition abroad.
    - Required documentation includes a 1) foreign shipper declaration and 2) importer’s endorsement.
    - Alternative documentation may be accepted by the port, such as Manufacturer’s Affidavit.
  - In Mexican maquiladora context, 9801 will be most applicable to return of unused or defective goods, or packaging materials accounted for separately at importation.
9801 & 9802 Considerations (cont.)

- HTSUS 9802.00.40 or 50 – Goods Returned After Repair (19 C.F.R. §10.8)
  - Required documentation includes a
    - 1) foreign repairer’s declaration and
    - 2) importer’s endorsement.

- HTSUS 9802.00.40 or 50 – U.S. Origin Goods Returned After Assembly Abroad (19 C.F.R. §10.11-26)
  - Required documentation includes a
    - 1) foreign assembler declaration and
    - 2) importer’s endorsement.
  - FIFO permitted if port director is satisfied with compliance.

- Only value or work and materials originating abroad will be dutiable.
Declared Value for Maquiladora Imports
Customs Valuation –
5 Hierarchical Appraisement Methods

- **Transaction Value**
  - *Arm’s length price demonstrated to include all costs plus a reasonable profit*

- **Transaction Value of Identical or Similar Merchandise**
  - *Based on the transaction value of previously imported merchandise*

- **Deductive Value**
  - *Selling price in the United States less certain post-importation costs*

- **Computed Value**
  - *Foreign supplier cost and expense information for materials, processing, profit, general expenses, etc.*

- **Fallback Method**
  - *Based on a modified version of 1 of the above 4 methods*
Appropriate Method of Appraisement

- With maquiladora shipments, it is often difficult to support transaction value given that:
  - Invoiced price does not generally include all costs plus a profit;
  - Invoiced price seldom reflects fully-loaded cost of production and required additions;
  - Assist values such as capital equipment depreciation and actual material costs are often excluded from standard cost;
  - There is typically no arm’s length sale for exportation to the United States;
  - Payment is often not tied to individual import transactions

- When these circumstances are present, Customs has generally held that a computed value method of appraisement is most appropriate for imports made from a maquiladora assembly operations
Computed Value

- The computed value of imported merchandise is equal to the sum of the following 4 elements:
  - Cost or value of materials, fabrication, and other costs necessary to produce the imported merchandise;
  - Profit and general expenses equal to those usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by the producers in the exporting country to the U.S.;
  - Assists, if not otherwise included above; and
  - Profit & Packing costs.
Cost Submission - Computed Value

- Customs’ cost submission, Customs Form 247, includes the following basic cost elements to build the actual computed value of imported product:
  - Actual material costs
    - Material costs, plus southbound freight, scrap, and variance
  - Foreign operating expenses related to the production of the imported product.
  - Assists
  - Profit
  - Packing (U.S. and foreign, may be included in material cost)
- Generally cost submission is completed annually in order to accurately reflect and allocate any year-end price adjustments.
Step One - Material Costs

- Material Component Costs
  - Material Cost
  - Freight
  - Variance
  - Scrap (less recoverable scrap)

- Importer’s option to capture materials costs for
  - Northbound shipments
  - Southbound shipments
  - Must remain consistent year-to-year with methodology chosen
Step Two - Foreign Operating Expenses

2. Foreign Operating Expenses
   a. Direct Labor
   b. Overhead:
      Production
      General & Administrative
      Total Operating Expenses
   c. Less: Non-Dutiable
   d. Net Operating Expenses
Foreign Operating Expenses

- General rule requires all of the foreign assembler's production and general expenses be included in calculating the amount for "profit and general expenses" in any computed value calculation.

- Ideally, the foreign operating expenses should be tied to the company's audited Mexican financial statement and general ledger detail:
  - prepared in accordance with Mexican GAAP ("Dictamen").
  - reported in U.S. dollars based on reported monthly exchange rates.
Foreign Operating Expenses (cont.)

Comments on Foreign Operating Expenses:

1. Costs should be taken directly from the expense account in the Factory Ledger.
2. Internal operating statements summarizing expense accounts should be attached to this submission.
3. A supporting schedule of non-dutiable expenses should be attached.
4. A supporting schedule of foreign currency conversion to U.S. dollars and methodology should be attached.
Step Three - Assists

3. U.S. Assist Costs* (other than materials included in item 1)
   a. Tools, dies, molds and similar items
   b. Merchandise consumed in production
   c. Engineering, development, artwork, design work and plans and sketches undertaken outside the United States
   d. Depreciation of general purpose equipment

   Total Assist Costs $ ____________
Assists — Defined

Assists are defined as:

- Materials, components, parts and other items used in production.
- Tools, dies, molds and similar items used to produce product.
- Merchandise consumed in production of the imported merchandise.
- Engineering, research, development, artwork, design work, plans and sketches produced other than in U.S.
- Other production expenses on the U.S. books.
Assists (cont.)

- Additional assist examples to watch out for include:
  - Consumable supplies such as grease, oil, solvents, production supplies.
  - Employee uniforms, gloves, protective goggles.
  - Anything related to the production in Mexico that are not otherwise captured within the Mexican foreign operating expenses.
  - Salaries and expenses associated with employees at the maquiladora that are carried on the U.S. books may be considered assists.
    - First line supervisor and below.
    - Operations and Plant Managers whose salaries are carried on the U.S. books are not assists.
      - If, however, their salary is paid by the maquiladora, then it is properly included in the foreign operating expenses (general expense) and reported as part of the cost submission.
Step Four – Profit and Packing

4. Profit (Actual)  

4a. Packing  

   U.S. Packing  

   Foreign Packing  

   Total  

5. Total Value  

The above information constitutes your submission of actual costs and value.
Profit

- Computed value requires the reporting of the foreign producer’s profit.
- The cost submission provides for profit as a separate line item.
- Profit should tie to the maquiladora’s operating profit as reflected on the audited Mexican financial statement, reduced by any profit for Mexican sales.
  - Converted to U.S. dollars using a weighted average currency conversion for the 12 month period.
  - The goal is to tie this profit figure to the maquiladora’s financial records.
- Include supporting documentation within the Excel workbook to support reasonable care and audit process.
U.S. and Foreign Packing

- Where packing is separately tracked and accounted for outside of the material costs
  - Allowed to deduct U.S. packing costs where HTSUS 9801 was claimed upon importation.
    - Adding them into the cost submission in Section 4a, and then backing them out again in allowable deductions in Section 6.
  - Foreign packing materials and costs should be included within the cost submission and total calculated dutiable value.
Completion of Cost Submission

- Upon completion of the cost submission there will be a “total value”
- This total value is to be compared against the total value declared to Customs during the corresponding period for product produced at the maquiladora.
- Any difference in value should then be allocated against those products produced or manufactured in the maquiladora (where there was value added).
- The value of product simply returned to the U.S., such as obsolete inventory or scrap, should not be adjusted.
- Similarly, returned used equipment to the U.S. should not be further adjusted.
Reconciliation

- Cost submission and Reconciliation filing allows the importer, using reasonable care,
  - to file entry summaries with Customs with the best available information,
  - with the mutual understanding that certain value elements or adjustments remain outstanding.
  - At a later date, when the specifics have been determined, the importer files a Reconciliation which provides the final and correct information.
  - The Reconciliation is then liquidated, with a single bill or refund, as appropriate.

- Given delays in finalizing year-end financial data for maquiladoras, including provision of audited financial statements, Customs extended the reconciliation period to 21 months from date of entry.
For More Information on Reconciliation …

Tune in April 30, 2015 when my colleagues James Sawyer and Mollie Sitkowski present:

“Relax. It's Just Recon!”

The webinar that promises to answer all of your Reconciliation questions (my promise, no theirs).
THANK YOU -- Questions?

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