



Canadian customs and global trade alert

The United States – Mexico – Canada Trade Agreement (USMCA): NAFTA 1.1?

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Overview

On September 30, 2018, shortly before a midnight deadline, Canada, the United States and Mexico (the Parties) announced the completion of North American Free Trade Agreement (NAFTA) renegotiations. The result is a

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rebranded deal known as the United States-Mexico-Canada Agreement (USMCA).¹ Notably, the rebranded agreement omits the words “free trade”. Arguably, the term “free trade” would be a misnomer. The agreement provides for government managed trade as well as many other matters including investment, labour mobility and so on. Regardless of the name assigned to the deal, it is clear that the news of the completion of the USMCA was welcomed by many Canadian businesses. The USMCA preserves key elements of the relationship developed between the Parties under NAFTA, develops new rules to deal with modern business issues, and makes changes that will affect every business that imports or exports goods within the trade bloc. Now is the time to prepare for the business opportunities and the regulatory challenges presented by completion of this agreement.

Once ratified, the USMCA is expected to bolster North American trade, investment and business growth. This is the latest development in a regional integration process that has spanned decades, beginning with the Automotive Products Trade Agreement of 1965 (which is better known as the Canada-US Auto Pact). The process of regional integration accelerated under NAFTA in 1994. Last year, the total trade between the NAFTA Parties reached \$1.1 trillion (USD). Collectively, the Parties account for 28% of the world’s gross domestic product (GDP). The development of the North American trade bloc has opened export markets, stimulated international business and helped to attract foreign investment.

The signing of the USMCA is a key development for the Canadian economy and the implementation of this deal may help to improve Canadian business opportunities and job prospects well into the future. Given the importance of this agreement, the Global Trade Advisory team will be tracking the progress of the USMCA towards ratification. At this point in time, we are able to offer the following key observations.

Scrubbing, consultation and ratification

The path towards the ratification of the USMCA and replacement of NAFTA will take time. Steps in this process towards ratification include the “legal scrubbing” of the initial version (that is, a legal review for accuracy, clarity, consistency and language authentication). There will also be some opportunity for consultation with government entities, such as Global Affairs Canada, in respect of the expected impact of the USMCA. Representatives of the Parties will likely hold a formal signing ceremony in late November 2018. The Parties will likely develop USMCA implementation legislation for potential review and ratification next year.

National treatment and market access for goods

USMCA Chapter 2 “National Treatment and Market Access For Goods” states that “originating goods” (that is goods that qualify as originating under rules of origin set out in Chapter 4) are entitled to preferential tariff treatment. No Party to the agreement shall increase any existing customs duty, or adopt any new customs duty on an “originating good”. Each Party shall apply customs

¹ The text of the USMCA has been posted online. See the Office of the United States Trade Representative, *United States-Mexico-Canada Agreement Text*, online: <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/united-states-mexico#>

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duties on originating goods in accordance with its Schedule, and may consult to consider accelerating or broadening the scope of the elimination of customs duties. The term "customs duty" in Chapter 2 does not include "anti-dumping or countervailing duty".

Agriculture

Chapter 3 of the USMCA concerns agriculture. A focus of the US Trade Representative's office in the renegotiations has been on improving the ability of US farmers to supply goods into Canada. At issue has been Canada's supply management system, which applies to agricultural goods such as dairy, poultry, and eggs. The system was developed in the 1970s to ensure that Canada had a strong and vibrant agricultural industry, and to manage the supply of such goods as a means of regulating food prices. A key element of the system has been the issuance of tariff rate quotas. Importers may apply to Global Affairs Canada for import quota allocations in order to import and classify goods under an import permit, classify them under a "within access commitment" tariff provision, and pay normal rates of duty. A "tariff wall" (punitive rates of duty) is imposed on certain goods unless they are imported under an import permit. The supply management system has limited the ability of US farmers to sell goods into Canada. Among other things, it appears that under the USMCA, the US farmers will obtain increased market access and share in respect of goods such as dairy and poultry (turkey). The deal allows US farmers greater access to 3.6 percent of Canada's dairy and poultry market. This increased market access may be slightly greater than the market access that Canada offered under the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).

Rules of origin

Businesses engaged in the business of importing and exporting goods within the USMCA territory will need to review, understand and comply with revised product specific rules of origin. USMCA Chapter 4 contains product specific rules of origin. Changes in product specific rules of origin under the USMCA may affect how goods (ranging from agricultural products to automobiles, and from textile and apparel to chemicals) qualify for preferential tariff treatment. The USMCA includes NAFTA rules of origin concepts (including terms such as "originating good", "originating material", "net cost", "transaction value", "accumulation", "regional value content" (RVC) and the "lesser of the two duties" duty refund limitation). Additionally, the USMCA appears to incorporate principles found within the CPTPP.

USMCA trade negotiators focused on rules of origin for the auto industry. Changes in these rules of origin include the upwards adjustment of the RVC requirement (that is, the value of inputs into a finished good which must originate in a particular territory in order to qualify for preferential tariff treatment). In general, the USMCA will require an upwards adjustment to the RVC requirement: from 62.5 percent under NAFTA to 75 percent under the USMCA. The USMCA will also cap the number of vehicles that may be exported into the United States free of the section 232 tariffs on an annual basis at 2.6 million vehicles. The USMCA will introduce wage requirements (for example, up to 40 and 45 percent of certain vehicles must be manufactured using labour at the rate of at least \$16 per hour by 2023). This wage requirement may most affect Mexican production facilities.

Customs administration and trade facilitation

Under USMCA Chapter 7, the Parties affirm their rights and obligations under the World Trade Organization's (WTO) Trade Facilitation Agreement. The Parties must administer customs procedures in a manner that facilitate the import, export and transit of a good. Provisions similar to those found in NAFTA deal with such matters as Advance Rulings (Article 7.5) and Express Shipments (Article 7.8). With respect to Express Shipments, Canada and Mexico raised their *de minimus* thresholds (the value below which goods may be imported duty-free). Canada agreed to a \$150 (CDN) *de minimus* threshold for customs duty purposes. A \$40 *de minimus* threshold will apply respecting goods and services tax (GST) which might otherwise be levied, collected and remitted as if it were a customs duty, pursuant to Division III of the Excise Tax Act.

One of the criticisms of NAFTA was that it provided for little self-governance. The USMCA provisions make a significant improvement in this respect. Article 7.22 establishes a Trade Facilitation Committee composed of government representatives of each Party. The committee has a broad mandate. Among other things, this committee shall facilitate the exchange of information regarding the formulation and implementation of, and experiences with, each Parties' measures that promote voluntary compliance.

Binational trade remedies disputes panel

The selection of a trade remedies dispute resolution mechanism was a hot button issue in the renegotiations. Canadian officials, from former Prime Minister Mulroney (who signed NAFTA) onwards, have argued that anti-dumping and countervailing disputes with the United States should be dealt with by a specialized panel (rather than by the US court system). To the extent that the WTO provides dispute resolution, Canada rejected this option on grounds including that the US government may not consider itself to be bound by a WTO ruling. NAFTA Chapter 19 provisions (which provided a specialized panel with jurisdiction to deal with anti-dumping and countervailing disputes) are continued in the USMCA. USMCA Chapter 10, Section D "Review And Dispute Settlement In Antidumping And Countervailing Duty Matters Between The United States And Canada," Article 4 allows each Party to seek a binational panel review of final antidumping and countervailing duty determinations.

Modernization

The USMCA preamble states that the Parties designed it to replace NAFTA with a 21st Century, high standard, new agreement to support mutually beneficial trade, leading to freer, fairer markets, and robust economic growth in the region. The USMCA contains several provisions designed to address concerns of modern trade and commerce. This includes Chapter 19 on digital trade that applies to measures adopted or maintained by a Party that affect trade by electronic means. The purpose of this chapter is to provide frameworks that promote consumer confidence in digital trade and the avoidance of unnecessary frameworks to its use and development. For example, no Party shall impose customs duties in connection with the import or export of digital products transmitted electronically within the USMCA territory. The Parties shall endeavor to accept trade administration documents submitted electronically. Additionally, the Parties must adopt a legal framework that provides for the protection of personal information of digital trade users.

Protection of cultural industries

One key Canadian demand in the renegotiations was the protection of cultural industries. The term “cultural industry” is defined in Article 32.6 of the USMCA. The term includes a person engaged in the activities such as: (1) the publication, distribution or sale of books, magazines, periodicals or newspapers; (2) the production, distribution, sale or exhibition of film, video recordings, audio or video music recordings; the publication, distribution or sale of music in print or machine readable form; and (3) radio communications and radio, television, cable broadcasting, satellite programming and broadcasting network services. The USMCA does not apply to a measure adopted or maintained by Canada with respect to a cultural industry, except as specifically provided for under Article 2.3 “National Treatment and Market Access for Goods – Tariff Elimination” or Annex 15-D “Simultaneous Substitution”.

Canada’s ability to sign other free trade agreements

Canada has negotiated and signed free trade agreements with many countries other than the United States as part of an economic growth and diversification strategy. In the days after the release of the initial text of the USMCA, some concerns have been expressed about the possible impact that the deal may have on Canada’s future trade negotiations. It has been suggested that the USMCA constrains Canada’s ability to sign free trade agreements with countries such as China in the future. This concern seems to stem from the words of USMCA Article 32.10 “Non-Market Country FTA”. A non-market country is essentially a country whose economy relies heavily upon government intervention. Paragraph 1 states in part that “At least 3 months prior to commencing negotiations, a Party shall inform the other Parties of its intention to commence free trade agreement negotiations with a non-market country.” Paragraph 4 states that “Entry by any Party into a free trade agreement with a non-market country, shall allow the other Parties to terminate this Agreement on six-month notice and replace this Agreement with an agreement as between them (bilateral agreement).” The right of Parties under paragraph 4 of Article 32.10 of the USMCA on six months’ notice is consistent with the right of the Parties under NAFTA Article 2205 to withdraw upon giving six months’ notice. In this regard, the ability of a Party to withdraw upon giving six months’ notice is not a new development. Canada’s Minister of International Trade Diversification, Jim Carr, recently appeared to confirm this position. He has indicated that the USMCA will not affect Canada’s sovereignty and that Canada will continue to pursue the completion of other trade agreements.

US steel and aluminum tariffs / Canadian countermeasures

During the course of the NAFTA renegotiations, US President Trump issued executive orders to increase tariffs on certain steel (by 25 percent) and aluminum (by 10%) goods imported into the United States on the national security grounds, pursuant to section 232 of the Trade Expansion Act of 1962. Canada was provided with a short-term exemption in order encourage its negotiating team to conclude the renegotiations within a deadline established by the United States. When the renegotiations did not conclude within the deadline, the exemption expired and the US tariffs were imposed on certain steel and aluminum goods imported into the United States from Canada. Subsequently, Canada imposed dollar-for-dollar countermeasures, thereby

increasing surtaxes on up to \$16.6 billion (CDN) of goods originating in the United States, pursuant to US originating steel, aluminum and other goods. These surtaxes have been levied in Canada as of July 1, 2018, pursuant to United States Surtax Order (Steel and Aluminum): SOR/2018-152 and the United States Surtax Order (Other Goods): SOR/2018-153. The US tariffs and the Canadian surtaxes were not resolved under the USMCA. However, it is expected that the United States and Canada will remove the tariffs and surtaxes before the Parties formally sign the USMCA in late November.

Intellectual property

The deal extends copyright terms to 70 years beyond the life of the author, up from the current 50. The deal also extends the period to ten years from eight that a new generation of pharmaceutical drugs can be protected from generic competition.

Summary

The USMCA will affect almost every business engaged in cross border trade with the United States and Mexico. Canadians who were bracing for major adverse outcomes of the NAFTA renegotiations can now breathe a sigh of relief. While there are winners and losers in any trade deal, it appears that in general the USMCA builds upon NAFTA and CPTPP rules. Importers, exporters, freight forwarders, shippers, and others who are engaged in the business of trade between Canada, the United States and Mexico will be impacted. These types of business will need to review and understand the new rules for trade in North America once the rules in the USMCA have been ratified. The Global Trade Advisory Team is ready to help.

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