

NAFTA May Be Replaced by USMCA: What Would That Mean for Your Taxes?

By Juan Arau and Anuar Estefan

On September 30, 2018, representatives from Canada, Mexico and the United States of America (the “U.S.”), announced that after thirteen months of intense negotiations, the three countries reached a preliminary agreement. This agreement revises the terms of the North American Free Trade Agreement (“the NAFTA”).

The full text of the proposed agreement was published by the U.S. government on October 1, 2018, under the name *The United States – Mexico – Canada Agreement* (“the USMCA”). Rather than being an amendment to NAFTA, the USMCA is a restatement that supersedes NAFTA.

The USMCA consists of thirty four chapters, whereas NAFTA included twenty two. The new chapters cover labor, the environment, digital trade, data storage requirements, and macroeconomic policies. The USMCA, as currently proposed, is complemented by side letters. These side letters cover how certain products of Canada and Mexico will be treated if the U.S. proceeds to impose additional duties on automobiles and auto parts.

The USMCA’s objectives are to preserve and expand *regional trade and production in the region*, and facilitate *trade between the parties, by promoting efficient and transparent customs procedures*. The USMCA is not heavy on tax regulation. It mainly focuses on international trade and customs issues.

Procopio’s International Tax Practice Group analyzed the USMCA in order to identify relevant provisions that may impact our clients and friends.

In general terms, the provisions contained in NAFTA regarding investment and immigration did not change substantially. However, there are certain provisions worth mentioning:

INVESTMENT

- Chapter 14 (Investment) defines a *covered investment* as an investment in the territory of any party to the agreement, made by an investor of another state-party. This provides protection to *investments* (defined below) made prior to the USMCA’s effective date.
- *Investments*, under the USMCA, means any assets with the characteristics of an investment (e.g. commitment of capital or other resources, expectation of gain or profit, assumption of risk, etc.), that an investor owns or controls, directly or indirectly.
- Foreign trade protections such as National Treatment, Most-Favored Nation Treatment, and Minimum Standard of Treatment, are still guaranteed to an investor of a state-party, in or by other state-party.
- Article 14.9 (formerly NAFTA 1109) included *contributions to capital* (including the initial contribution), among those transfers¹ permitted to be carried out freely and without delay. Other permitted transfers

¹ There is not an express definition of the term “transfer.” USMCA Article 14.9 lists diverse actions that are considered “transfers.” Among the listed actions are the following: contributions to capital, profits, dividends,

include: profits, dividends, interest, capital gains, management fees, and proceeds from sale of all or part of a covered investment.

- Omissions or mistakes in *financial reporting or record keeping of transfers* was included as a reason why a state-party is allowed to prevent or delay a transfer, provided that any such delay is necessary to assist law enforcement or financial regulatory authorities.
- The USMCA revised NAFTA's provision regarding *Denial of Benefits*. It provides that a state-party may deny the benefits of the Investment Chapter to an investor of another state-party that is an enterprise² of that other state-party, and to investments of that investor, if the enterprise:
 - is owned or controlled by a person of a non-state party, or of the benefits denying party; and
 - has no substantial business activities in the territory of a state-party other than the benefits denying party.

IMMIGRATION

USMCA immigration-related provisions did not change when compared to those of NAFTA. Once the USMCA takes effect, the provisions related to B-1, E-1/E-2, L-1 and TN visas/permits, Business Visitors, Traders and Investors, Intra-Company Transferees, and Professionals in Canada and Mexico, will most likely remain the same.

The most important, *novel* provisions contained in the USMCA are the following:

Rules of origin / Automobiles and automotive parts.

- To qualify for zero tariffs, an automobile must have at least 75% of its components manufactured in the North American region (as opposed to NAFTA's 62.5%);
- A labor value content rule requiring that at least 40-45% of automobiles be manufactured by workers earning at least \$16 per hour by 2023. This was mainly introduced to raise salaries in Mexico at a level of those in the U.S. and Canada (or to bring jobs back to the U.S.);
- A requirement that at least 70% of steel and aluminum purchased by automobile manufacturers is purchased and produced in the North American region.
- Stricter rules of origin for several other products, such as chemicals, glass, optical fiber, and textiles.
- Canada has agreed to open (in a limited manner) its dairy and produce markets to U.S. producers. The U.S. will open, also in a limited manner, its dairy, peanuts and sugar markets, to Canadian producers.

interest, capital gains, royalty payments, management fees, technical assistance, proceeds from the sale of all or a part of the covered investment, or from the partial or complete liquidation of the covered investment, and payments made under a contract, including payments made pursuant to a loan or employment contract.

² Trusts are expressly acknowledged as enterprises pursuant to USMCA's Article 1.4 – General Definitions.

- Streamlined certification and verification of rules of origin. Producers, exporters or importers will now be allowed to certify the origins of goods.
- Dispute settlement through an arbitration panel with a member from each state-party.
- Sunset clause providing the USMCA will terminate after sixteen years, unless an extension is agreed to by each state-party for an additional term of sixteen years. The USMCA will be reviewed every six years to determine if amendments are needed.

We view the USMCA in principle as good news and beneficial for many clients; nevertheless, this was only the first step of the process. The agreement must be executed by the executive branch of the three state-parties and approved by their legislatures. Canada and Mexico will most likely have the agreement approved without much delay. In the case of the U.S., the mid-term elections will be an important factor, because it is not clear if the agreement will have enough votes for its approval. Until the USMCA is passed, NAFTA will remain in effect.

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