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Possible Relief from New Tariffs — and Risks to Avoid

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Tariffs have been in the news almost daily. Not only have tariff rates changed repeatedly, but the deadlines around implementation are subject to change. Meanwhile, the list of new commodities that are subject to additional tariffs continues to grow. All of these changes have made it extremely difficult for U.S. businesses to plan. For government contractors, the tariffs add a layer of complexity to already complicated contractual obligations. Clients often ask whether they have any recourse on tariffs that increase the cost of goods they must deliver under their government contracts.

COST OF TARIFFS MAY BE RECOVERED/EXEMPTED UNDER FAR/DFARS

The good news is that there may in fact be some recourse under various Federal Acquisition Regulation (FAR) provisions. FAR clauses like 52.229-3, Federal, State and Local Taxes and 52.216-4, Economic Price Adjustment – Labor and Material may allow for cost recovery or schedule adjustments when tariffs are imposed after contract award or modify preexisting tariffs and increase the cost of performance. The ability to recover costs depends on the contract type, timing of the tariff imposition, and whether the contractor properly notifies the Contracting Officer and provides supporting documentation. Contractors with fixed-price contracts should review them to determine whether they contain either of the above clauses, or similar clauses. Such clauses might provide a route for recovery of the additional costs based on the imposition of an after-imposed federal tax, or an increase in price covered by an economic price adjustment clause. While there is no guarantee that all costs for new or increased tariffs will be recoverable, there may be room to negotiate a price adjustment if the change is within the scope of the clause and the contractor provides timely notice.

If recovery for increased costs is not an available option, you may want to check to see if there is an available exemption under any U.S. Customs and Border Protection (CBP) law or regulations. FAR Subpart 25.9 and Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 225.9 provide policies and procedures for seeking such potential exemptions from duties applicable to certain foreign supplies purchased under government contracts.

This is a complex area and contractors should carefully review the categories of supplies covered by the exemptions, the CBP law and regulations, and whether their contracts contain relevant FAR, DFARS or other clauses (*e.g.*, FAR 52.225-8, Duty-Free Entry, and DFARS 252.225-7013, Duty-Free Entry) to determine: (1) whether any relevant supplies are eligible for an exemption, (2) the deadline for notifying the Contracting Officer to seek an exemption, and (3) when they can buy the supplies (*e.g.*, an exemption is unavailable to contractors that have already bought the supplies and paid for the duty).

Subcontractors may also be eligible to seek an exemption by directly notifying the government of products or supplies eligible for duty-free entry. *See, e.g.*, DFARS PGI 225.902 ("Upon receipt of the required notice of purchase of foreign supplies from the contractor or any tier subcontractor...."). That said, contractors should consider including in their lower-tier subcontracts' duty-free clause(s) the requirement that subcontractors also notify the higher-tier contractor to ensure that the prime contractor is aware of what duty-free exemptions are available and sought under their prime contracts.

Experienced government contracts and trade counsel can help navigate these complex contractual issues. Reach out to our Government Contracts team for assistance evaluating these matters.

THE IMPORTED GOODS MAY NOT BE CORRECTLY CLASSIFIED

Another route to explore is whether your goods are correctly classified, which can help avoid surprise bills on duties from CBP. Consider engaging expert trade counsel to determine whether the imported goods are in fact properly classified under the Harmonized Tariff Schedule of the United States (HTSUS). Counsel can review the current HTSUS classification and research whether any relevant CBP rulings might warrant a different classification of the goods. CBP rulings are available through the Customs Rulings Online Search System. Trade counsel can also help importers seek a binding ruling letter from CBP in a number of areas, which include: tariff classification, country of origin marking, country of origin determinations and the applicability of United States-Mexico-Canada Agreement and other trade preference programs. These requests are submitted electronically to the National Commodity Specialist Division of Regulations and Rulings and responses generally take 30 calendar days. The benefit of binding ruling letters is that they provide certainty. The downside of such letters is that a binding letter is harder to challenge if an importer disagrees with that decision, though such a challenge can be done via an administrative appeal and may not require formal litigation.

There remains uncertainty as to whether and, if so, which tariffs will be in place and be applicable to both commercial and public sector contracts, grants and agreements. President Trump has repeatedly changed which countries and tariff amounts will apply, and litigation concerning the constitutionality and primacy of Congress over tariff questions is pending for several issues, including whether the International Emergency Economic Powers Act (IEEPA) tariffs imposed by President Trump will be upheld. Cases challenging the validity of IEEPA tariffs are currently pending in the Federal, D.C. and Ninth Circuits. If the IEEPA tariffs are ultimately declared to be unlawful, then importers may need to request refunds on affected entries depending on what guidance CBP issues. Our team is monitoring these issues closely and is able to provide advice tailored to your business planning needs. In this environment, counsel with the relevant expertise can help you identify your options and how to navigate the various potential pitfalls.

Our International Trade team can counsel you on the complexities of the entire importing process and can provide practical advice on how to navigate the uncertain tariff landscape.

COMBATING TARIFF EVASION IS ONE OF DOJ'S TOP ENFORCEMENT PRIORITIES

On May 12, Matthew Galeotti, head of the U.S. Department of Justice's (DOJ) Criminal Division, sent a memorandum that reflects changes in DOJ's enforcement priorities. Galeotti listed 10 "high-impact" areas of focus, which included "[t]rade and customs fraud, including tariff evasion." He said, "[t]rade and customs fraudsters" were "undermin[ing] the Administration's efforts to create jobs and increase investment in the United States." He placed tariff evasion as a necessary focus for DOJ because it is a "threat[] to the U.S. economy, American competitiveness, and our national security."

In addition to violating customs law, tariff evasion violates the False Claims Act (FCA). One of the most common forms of customs fraud, tariff evasion occurs when the country of origin or tariff classification is incorrectly identified on the entry paperwork filed to import goods. A related tactic is tariff misclassification. Whatever the tactic, the result is the same, defrauding of the federal government. With the recent surge in tariffs, customs fraud, including tariff evasion, has become both a civil and criminal FCA enforcement priority for DOJ.

An FCA violation risks both statutory penalties (penalties currently range from approximately $14,000 to $28,000 per false claim) and treble damages. Given the prioritization of customs enforcement both in the FCA and customs contexts, it has become increasingly important to ensure that the information submitted to CBP is error free and reasonably compliant with existing customs and laws. And for government contractors, an FCA violation also risks imposing suspension or debarment of the company (and possibly malfeasant individuals) prohibiting them from being awarded new federal contracts or having options to continue their existing government contracts exercised. Federal grant and agreement recipients also face these issues, and an FCA violation for tariff evasion can result in their suspension or debarment from being awarded grants or other federal agreements. Further, suspension or debarment at the federal level may lead

to reciprocal suspension or debarment at the state or local government contract level.

When the DOJ opens an investigation on its own or because of a whistleblower report, targets and other market participants (who may not be targets of the investigation) often receive a Civil Investigative Demand (CID). A CID is a type of administrative subpoena. In criminal investigations, targets and witnesses often receive Grand Jury Subpoenas. Once a CID or Subpoena is issued, companies need to engage experienced counsel quickly. Counsel can engage the DOJ to help negotiate the scope of the requests, negotiate for more time to respond, and conduct the necessary internal investigation to understand what has happened.

Companies can reduce their risk from a government investigation or enforcement action by ensuring that they have a rigorous compliance program in place, along with a robust internal mechanism for whistleblowers to report concerns.

Experienced FCA counsel can help navigate these complex issues. Reach out to our White Collar and Government Contracts teams.

If you have questions about this advisory, or particular contracts or grants, contact your Stinson counsel or the authors.

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