TSL
FEATURE

SFNet Members Weigh in on the Possible Elimination of the De Minimis Exemption

The de minimis exemption, which allows low-value international shipments to enter the U.S. duty-free, is under scrutiny in Congress. With proposals to eliminate or reduce this exemption, both Democrats and Republicans seem to agree on the need for change. If implemented, this could lead to higher costs for businesses and consumers alike, particularly impacting the e-commerce sector. SFNet members discuss the potential consequences of this shift on the secured finance industry.

BY MYRA THOMAS

While the political environment can sometimes be polarizing, many Republicans and Democrats in Congress seem to agree on one thing—the reduction or elimination of the de minimis exemption. The tariff exemption allows for zero duties and taxes on international shipments sent directly to U.S. businesses and consumers, when those items are valued under $800 per person or business, per day. Low-value imports are allowed duty-free under Section 321 of the Tariff Act. Documentation requirements are also less strict for de minimis imports. With pending Congressional proposals to eliminate the exemption, the Biden administration's previous support for it, and President Trump's vocal support of additional tariffs, the likelihood of a change to the de minimis exception seems likely.

If instituted, the resulting tariffs could be a boon for U.S. coffers, given the massive number of items coming into the country under the exemption. Over the past ten years, ending in fiscal 2023, the U.S. Department of Commerce estimates that shipments into the U.S. under the de minimis exemption increased from 140 million items to more than 1 billion. They estimate that approximately 4 million in exempted items entered the U.S. each day in 2023 alone. Much of the items appear to be coming from Chinese eCommerce platforms like Temu and Shein. While the true number of goods coming from these two companies is difficult to exactly pinpoint, a 2023 report from the House of Representatives' Select Committee on the Chinese Communist Party suggests that Temu and Shein are "likely responsible for more than 30% of all U.S.-bound daily volume that falls under the provision." Some retail experts also argue that this tariff and duty exemption may be leading Amazon to move to smaller warehouses in parts of Asia or Mexico to benefit from the exemption for international B2C shipments from there. Some small and medium-sized enterprises (SMEs), such as luxury goods manufacturers and made-to-order retailers, are also benefiting from the de minimis exemption.

A Deeper Dive into the Debate

With a significant portion of low-value consumer goods shipped to Americans from warehouses in Canada and Mexico, as well as from air shipments from China, the change could mean increased costs to the consumer and costly and needed changes to some company supply chains to handle inventory management and the related risks. But the trickle-down effect to most retailers and, ultimately, secured lenders, remains a source of debate. Salvatore Stile II, president of Alba Wheels Up International, argues that there is certainly a need for more details on the manifest for low-value goods coming into the US. to reduce drugs and other violations, but this can be mitigated by better processes.

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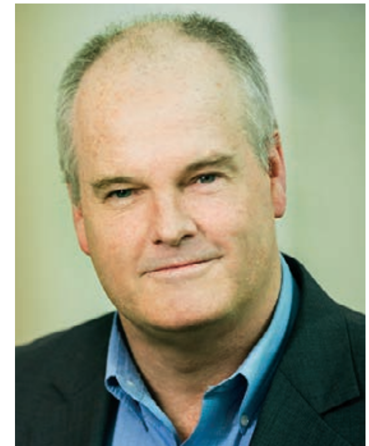

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According to Laura Siegel Rabinowitz, shareholder at Greenberg Traurig, LLP, this flood of low-value B2C products from abroad make it increasingly difficult for U.S. Customs and Border Protection (CBP) to adequately monitor and track all of it. The elimination of the de minimis exemption could help to stem the tsunami of goods into the U.S. The possible change in the exemption could simply be chalked up to the need to recapture tariffs and duties. But she also notes that "the risk of illicit drugs, as well as violations of trade laws and health and safety requirements, are very real concerns." There's the loss of duty and tariffs, of course, but there's also the potential for shipments of fentanyl, goods that have IP violations, items produced from forced labor, and some products that violate consumer protections. In fiscal year 2023, 85% of the shipments CBP seized for health and safety violations were small packages.

Despite the concerns, Stile notes that a complete elimination may not be a solution. A compromise may be in order, he adds. Smaller importers may not be prepared for the rise in the cost of some raw materials. Plus, future tariffs, especially those related to imports from China, may lead to an increase in the cost of customs bonds to cover increased duties, taxes, and fees. Fluctuations in tariffs could put some secured lenders at risk from importers that will be faced with surety bond stacking and required to post additional collateral to surety companies. With multiple surety bonds in place on the same underlying obligation, ABL and factor claims against a borrower's assets are ultimately diluted.

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The Cost Considerations

The closure of this loophole will also cause the impacted companies to reconsider their supply chain configurations, and secured lenders should be prepared to have critical discussions with those clients. "Think about your borrower's exposure and take steps to assess and mitigate risk now," Stile notes. At the moment, he says that ports and terminals are simply not efficient enough to handle possible changes to inspection, and a delay in shipments translate to a delay in the number of days until that retailer gets paid and a blow to cash flow. Lenders will need to keep a closer connection to the client, possibly increasing stress tests and establishing tighter loan covenants or reporting on collateral.

According to Andrew Barone, director of business development at Rosenthal & Rosenthal, the elimination of Section 321 would be detrimental to some businesses. Many direct-to-consumer brands have made significant strides towards profitability over the last 2 years since their investors focus has shifted from "grow at all costs" to "operating profitability." For companies doing $10MM+ in sales the duty savings are huge and directly contribute to their bottom line. An elimination would mean even more costs for these brands to figure out how to manage. And, at the same time with increasing inventory values, they will lean on their lender to help finance these cost shifts for freight and duty.

The Risk of Security Concerns

If the de minimis exception is removed or modified, there are certainly many companies that will face unexpected costs related to new regulatory and compliance consideration. CBP estimates de minimis shipments account for approximately 92% of all cargo entering the U.S., mostly made up of consumer clothing and smaller consumer goods. John F. Kennedy International Airport (JFK) in New York City, for example, processes about 750,000 de minimis shipments a day—roughly 25% of all de minimis shipments processed, notes Rabinowitz. And, she adds, U.S. government officials know that the items have entered the country, but they simply cannot monitor what is inside all of the packages and track where all of the items eventually end up. Along with four express courier facilities, including DHL, FedEx, and UPS, JFK Airport is home to the country's largest by volume international mail facility where 60% of international mail arrives.

Today, CBP is under significant and growing pressure to check for narcotics and other illicit goods coming into the

country by international mail, as well as precursor chemicals and such things as die molds and pill presses used to make fentanyl and other synthetic drugs. U.S. government officials concede that it's a near-impossible task to adequately review the majority of de minimis exempt packages. In a press release from Andrew Renna, assistant port director for cargo operations at JFK Airport and CBP de minimis task force lead, he noted, "We have limited resources. We only have X number of staff. There is no physical way if I doubled or even tripled my staffing that I could look at a significant percentage of that. So due to the volume, it's a very exploitable mode of entry into the U.S." The flood of smaller packages also presents a growing security risk, especially after anthrax mail-borne attacks.

Mixed Signals for Business

Changes may help mitigate those risks, but for companies shipping B2C goods from abroad, primarily from warehouses in Mexico or Canada, the impact on the supply chain from a de minimis elimination could be significant. According to Chris Fulman, managing director at FGI Finance, U.S. retailers who ship goods directly to consumers from abroad will experience a shift in their financial position. He notes, "B2C businesses shipping low-value items will undoubtedly require time to adapt and diversify their sourcing strategies." Supply chain shifts are expected to result in increased expenses for some U.S.-based companies, as they invest in automation to offset labor costs or compliance systems to manage the increased paperwork, documentation, and reporting requirements. Customers will likely see increased prices on some low-value goods to offset the higher import costs, but this could lead to losing price-sensitive consumers. Fulman points out that some asset-based lenders may face higher risks as collateral values tied to imported goods could become more volatile. If tariffs increase or documentation requirements tighten, the liquidity of inventory may be reduced, prompting lenders to adjust their loan-to-value ratios.

However, for the vast preponderance of U.S. businesses, it appears that secured lenders are not fretting a reduction or elimination of the de minimis exemption. Martin F. Efron, executive vice president and head of factoring for White Oak Commercial Finance, notes, "The spirit of the rule wasn't meant for large online marketplaces." Instead, he notes that it was meant for U.S. travelers bringing goods home and smaller businesses in need of samples from abroad. "Most of my clients that are importers of goods from overseas are not shipping direct to consumer, but to larger retail stores." A reduction or elimination of the de minimis exemption could be good news for many of his ABL and factoring clients. And, for the vast majority of U.S. companies, particularly retailers, the change is good news. Most major U.S.-based retailers are currently finding themselves at a disadvantage when shipping from domestic warehouses. These domestic retailers represent a large proportion of all ABL and factoring customers, say industry experts, and they are looking forward to a more competitive playing field as a result of higher costs on items shipped from abroad and direct to consumer.

A Look Ahead

How it all plays out certainly depends on the way the change is implemented and what countries will be impacted, says Alex Sutton, managing director and head of research, at Gordon Brothers. "It's not decided yet, and it could simply mean a drop in the current $800 exemption set in 2016 from the previous level of $200." If the de minimis exemption is reduced or eliminated, he notes that some smaller industrial products may see increased tariffs, but less expensive consumer products will bear the brunt of the change. Sutton also predicts distribution centers from northern Mexico, the U.S.'s closest neighbor, are likely to see a reduction in incoming shipments.

And, much like others in the secured finance space, Sutton says that only a small number of his clients take advantage of the de minimis exemption. He adds that even for those clients that are impacted, the concern may be a bit overblown. "From an appraisal perspective, we find that this type of event has, normally, a one-time measurable impact on inventory," Sutton adds. "The asset-based lending industry will be affected a little bit by that, but I do think it's a relatively small part of the secured lending business." He agrees that the vast majority of ABL and factoring clients are competing against companies that use the de minimis exception to ship inexpensive consumer goods.

Secured lenders and their clients are more concerned about the possibility of more far-reaching tariffs than the de minimis exemption. For now, the reduction or elimination of the de minimis exemption appears far less controversial and impactful for most U.S. businesses. While President Trump seems likely to move ahead on modifying the de minimis exemption, particularly for goods originating from China or on certain categories of products, it all remains up in the air. However, one new development is getting significant attention. On January 1, Mexico instituted new tariffs on some low-value imported goods coming through the country. The effect on companies such as Shein and Temu, as well as on U.S.-based retailers shipping through Mexico, are not yet fully understood but may change the playing field for these companies. Whatever the outcome may be and its impact, asset-based lenders and factors will always be needed to help navigate any supply chain management disruptions, changes, and risks, if and when, smaller or larger tariffs and duties impact U.S. companies with exposure.

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