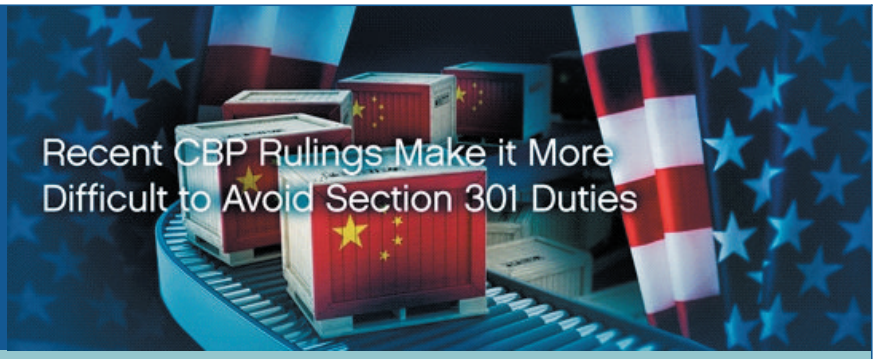
JONES DAY

COMMENTARY

NOVEMBER 2018



IN SHORT

The Situation: U.S. Customs and Border Protection ("CBP") recently issued rulings regarding Chinese-origin goods subject to additional duties under Section 301 of the Trade Act of 1974 ("Section 301").

The Developments: For purposes of assessing duties, CBP will now apply the substantial transformation standard to determine the country of origin of merchandise produced in Canada or Mexico using Chinese-origin components subject to Section 301 duties, rather than the North American Free Trade Agreement ("NAFTA") marking rules. Also, CBP clarified how Section 301 duties will apply to sets put up for retail sale.

The Impact: It may now be more difficult for companies to avoid paying Section 301 duties.

We previously described various options for parties seeking to avoid the additional 10 to 25 percent duties imposed on three sets of Chinese-origin products pursuant to Section 301, including shifting production locations to change the country of origin of Chinese-origin products and reevaluating whether the correct Harmonized Tariff Schedule of the United States ("HTSUS") subheading is being used for Chinese-origin products imported into the United States. Based on recent rulings issued by CBP: (i) it may now be more difficult for companies moving operations from China to Mexico or Canada (or potentially other countries with which the United States has a free trade agreement) to avoid Section 301 duties; and (ii) not all sets put up for retail sale qualify for favorable treatment.

Country of Origin

In ruling H300226 (September 13, 2018), CBP reconsidered an earlier ruling (N299096 (July 25, 2018)) related to the country of origin of an electric motor assembled in Mexico using three Chinese-origin parts subject to Section 301 duties. In ruling N299096, CBP applied the NAFTA marking rules to determine the country of origin of the final product for both duty and marking purposes. Those rules generally require that any non-Mexican-origin components undergo a requisite shift in tariff classification set forth in the tariff shift rule applicable to the final product's tariff classification.

In a surprising change of course, in ruling H300226, CBP explained that if operations in Mexico involve Chinese-origin components subject to Section 301 duties, the NAFTA marking rules apply only for purposes of determining the country of origin for *marking* purposes and that the substantial transformation standard applies for purposes of determining country of origin for *duty* liability purposes. This approach, which previously had been applied only in the context of antidumping and countervailing duties and safeguard measures, resulted in a final product that will be marked to indicate that it is of Mexican-origin but will be treated as Chinese-origin for purposes of assessing duties.

> Due to this ruling, it may be more difficult for companies to avoid Section 301 duties by sending Chinese-origin components subject to Section 301 duties to Canada or Mexico (or potentially other countries with which the United States has a free trade agreement) for use in making a final product.

Why this result? The NAFTA tariff shift rules are much more objective and, in many ways, easier to satisfy than the subjective, fact-specific substantial transformation standard, which requires that, in this case, the Chinese-origin components undergo a change in name, character, and use in connection with operations in Mexico. Due to this ruling, it may be more difficult for companies to avoid Section 301 duties by sending Chinese-origin components subject to Section 301 duties to Canada or Mexico (or potentially other countries with which the United States has a free trade agreement) for use in making a final product.

In contrast, in ruling N298549 (July 31, 2018), CBP considered the country of origin for U.S.-origin steel tubing that was further processed into fence posts in Mexico to determine whether the tubing would be subject to the additional duties on steel under Section 232 of the Trade Expansion Act. In ruling N298549, CBP applied the NAFTA marking rules for determining the final product's country of origin for marking *and* duty purposes.

Given the lack of apparent legal basis for the difference between ruling H300226 and ruling N298549, we expect that someone will challenge the holding in ruling H300226.

Sets Put up for Retail Sale

To classify a product under the HTSUS, importers must apply the General Rules of Interpretation ("GRI"). Sets put up for retail sale can either be specifically described in a HTSUS subheading that covers certain types of sets (i.e., under GRI 1), or, if there is not an applicable HTSUS subheading, can be classified under GRI 3 if certain requirements are satisfied.

In an FAQ on CBP's website, CBP addressed how Section 301 duties will be assessed on sets put up for retail sale that contain components subject to the Section 301 duties:

- When importing goods put up in sets for retail sale (in accordance with [GRI] 3) that contain articles subject to the Section 301 remedy, if the product that imparts the essential character to the set (i.e. the HTSUS provision under which the entire set is classified) is covered by the Section 301 remedy, then the entire set will be subject to the additional 25% duties.

- If the HTSUS provision under which the entire set is classified is not covered by the Section 301 remedies, but the set contains components that are classified in a subheading covered by the 301 list, the 301 duties will not be assessed on the individual components.

In ruling H299857 (September 6, 2018), CBP considered the applicable rate of duty for a Chinese-origin 129-piece toolset, which contained five Chinese-origin components subject to Section 301 duties. The set was classified pursuant to GRI 1 under subheading 8206.00.00 of the HTSUS, which provides for "[t]ools of two or more headings 8202 to 8205, put up in sets for retail sale." The general rate of duty applicable to products classified under HTSUS subheading 8206.00.00 is the "rate of duty applicable to the article in the set subject to the highest rate of duty."

CBP held that because the set was classified under a specific HTSUS subheading pursuant to GRI 1 (i.e., HTSUS subheading 8206.00.00), the FAQ was not applicable and, therefore, the set's applicable rate of duty was that of the component that had the highest rate of duty. Because the five Chinese-origin components subject to Section 301 duties were individually dutiable at 28.9 percent (3.9 percent ordinary duties plus the additional 25 percent Section 301 duties), the entire set was dutiable at 28.9 percent.

The above-described rulings make it clear that CBP is taking, and likely will continue to take, an aggressive approach to imposing the Section 301 duties. As a result, it may be more difficult for parties to avoid such duties.

THREE KEY TAKEAWAYS

1. CBP is taking an aggressive approach to imposing Section 301 duties.
2. Recent rulings issued by CBP relating to country of origin and tariff classification make it more difficult for parties to avoid paying Section 301 duties.
3. Companies seeking to avoid Section 301 duties should stay up to date on guidance, FAQ, and rulings issued by CBP.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