

CBP Ruling Determines “Substantial Transformation” Requirements Trump NAFTA Marking Rules for Application of Section 301 Tariffs and Trade Remedy Duties

On September 13, 2018, U.S. Customs and Border Protection (CBP) issued a significant ruling, HQ [H3000226](#), that distinguished between North American Free Trade Agreement (NAFTA) country-of-origin marking rules and the country-of-origin rules applying to products subject to Section 301 tariffs and trade remedy duties. CBP determined that Chinese-origin components (stators and rotors) imported into Mexico for further assembly into a finished product (electric motor) satisfied the requirements for marking the assembled product as a product of Mexico in accordance with the NAFTA Marking Rules; however, it ruled that the Chinese-origin stators and rotors were not “substantially transformed” into an electric motor in Mexico and that the assembled electric motor remained a product of China still subject to the U.S. government’s Section 301 retaliatory tariffs on imports of Chinese electric motors, which went into effect July 6, 2018, and to any potential trade remedy duty.

CBP’s Determination

CBP’s determination may seem confusing. How can a product be marked as a Mexican product but be identified as a Chinese product subject to Section 301 tariffs and trade remedy duties? For marking purposes, CBP reasoned that Part 102 of its regulations, the NAFTA Marking Rules, required that the product be marked as a product of Mexico. These NAFTA Marking Rules are prioritized in Part 134.1 of the CBP regulations, “Country of Origin Marking,” which states that “for a good of a NAFTA country, the NAFTA Marking Rules will determine the country of

origin.” Although it was bound by Part 102, the NAFTA Marking Rules, for identifying the marking required at the time of entry for the product from Mexico into the United States, CBP ruled that it must also analyze whether the components were “substantially transformed” in Mexico to determine the country of origin for the application of both Section 301 tariffs and trade remedy duties.

In a 2016 opinion, the U.S. Court of International Trade (CIT), based on numerous precedents from the last 75 years, identified what constitutes “substantial transformation.” The CIT determined that a substantial transformation occurs when a product emerges from a manufacturing process with a new name, character and use. The “simple assembly” of a limited number of components does not constitute a substantial transformation. See *Energizer Battery, Inc. v. United States*, 190 F. Supp. 3d 1308 (Ct. Int’l Tr. 2016).

Once CBP determined that the manufacturing process for the completed electric motor was a simple assembly process and thus the Chinese-origin components were not substantially transformed, it ruled that the country of origin of the electric motor was China for the application of Section 301 tariffs and trade remedy duties. CBP held: “When considering a product that may be subject to antidumping, countervailing, or other safeguard measures, the substantial transformation analysis is applied to determine the country of origin.”

It appears that this CBP ruling could, at times, conflict with NAFTA Article 401(b), the “tariff shift” rule, which states that a good:

shall originate in the territory of a Party where ... each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the Parties, or the good otherwise satisfies the applicable requirements of that Annex where no change in tariff classification is required, and the good satisfies all other applicable requirements of this Chapter.

A CIT appeal on this ground, challenging the “substantial transformation” criteria CBP applied in its ruling, may have merit.

What Does This Mean for Importers?

CBP’s determination in HQ H3000226 requires importers to understand thoroughly their supply chains, including the manufacturing processes of their suppliers and the origin of components used in those manufacturing processes. A company’s ability to show that an imported product is the result of a substantial transformation may prevent a financially harmful surprise when the product is imported into the United States.

FOR MORE INFORMATION

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