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Proposed Changes to Compliance Standards for the Trade Agreements Act May Add Complexity

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Determining compliance with the Trade Agreements Act ("TAA") of 1979 has never been easy, but proposed rule changes intended to create predictability may add new complexity to the process. The U.S. Customs and Border Protection ("CBP") has statutory and regulatory authority to issue country-of-origin advisory rulings and final determinations, including the TAA's "rule of origin" standard.[1] Determining the country of origin of manufactured goods under the TAA has been more of an art than a science, requiring companies to make country of origin determinations using the highly subjective "substantial transformation" test. On July 25, 2008, CBP proposed extending application of the "tariff shift" test and related rules set forth in 19 Code of Federal Regulations ("C.F.R.") Part 102 to all country-of-origin determinations made under the customs and related laws and navigation laws of the United States, with certain exceptions.[2] The tariff shift test, which currently applies to trade among North American Free Trade Agreement ("NAFTA") countries, would essentially replace the traditional substantial transformation test, including the test for making TAA country-of-origin determinations.

The fundamental purpose of the TAA is to eliminate discriminatory treatment of "eligible products" from designated foreign countries in government procurements. In so doing, it severely restricts the purchase of products from non-designated countries and prohibits contractors from providing non-compliant products. Under the TAA, an article is considered to be a product of a country if it is "wholly the growth, product or manufacture" of that country or, in the case of an article consisting in whole or in part of foreign materials, it has been substantially transformed into a "new and different article of commerce." The courts have held that "substantial transformation" occurs when as a result of a process, a new and different article emerges, "having a distinctive name, character or use."[3] The subjectivity inherent in this standard requires a case-by-case analysis of the products at issue and often results in uncertain determinations. For government contractors attempting to implement TAA compliance, the potential consequences for "getting it wrong" can be quite severe.

According to CBP, the Part 102 rules of origin will result in determinations that are more objective and predictable. Part 102 establishes a sequence of analytical steps for determining the country or countries of origin for an imported good. In certain circumstances, the country of origin can be determined relatively quickly. In others, one must work through a series of steps or rules to arrive at the answer.

The tariff shift test is the first step in the analytical process. It provides that the country of origin for an imported good is the country in which: (1) the good is wholly obtained or produced; (2) the good is produced exclusively from domestic materials; or (3) each foreign material incorporated in the good undergoes an applicable change in tariff classification, i.e., "tariff shift."[4] The actual mechanics of determining whether a tariff shift occurs for *each* foreign material incorporated in a good are complex.

Briefly, goods are classified in accordance with the Harmonized Tariff Schedule of the United States ("HTSUS"). The HTSUS sets forth a hierarchical structure for describing all goods in trade based upon the international Harmonized Commodity Description and Coding System ("HS"), administered by the World Customs Organization. Using this hierarchy, goods are classified into chapters, headings, and ultimately, subheadings.[5] Part 102 establishes rules for determining whether a tariff

shift occurs when a constituent material is incorporated into a final end product; that is, when the constituent material is reclassified from its original subheading to the subheading for the final end product. Take, for instance, a drink mix comprised of sugar, citric acid, corn syrup, natural and artificial flavors, dehydrated lime juice, and artificial colors, and processed into final form in Canada; assume all of the ingredients except for the sugar are products of Canada. For Canada to be considered the country of origin for the drink mix, the non-originating sugar (subheading 1701.11) must satisfy the applicable tariff shift rule when it is reclassified under the subheading for the drink mix (subheading 1701.91.54). In this case, it does not.[6] Consequently, because not all of the foreign materials incorporated in the drink mix underwent a tariff shift, Canada is not the country of origin. To determine the country of origin, a contractor would move to the next step in the analytical process, and continue to do so until one of those steps yields a country-of-origin determination.[7]

Under the proposed rule, the uncertainty inherent in the substantial transformation test would be replaced by the complexity inherent in the Part 102 rules of origin. Compliance with the proposed rules will no doubt increase the cost of doing business, as companies put in place policies, procedures, and personnel to perform the country-of-origin determinations. Moreover, companies may find that goods once thought to be compliant with the TAA under the substantial transformation test are no longer compliant under the Part 102 rules of origin.[8]

Footnotes

[1] CBP is charged with issuing country-of-origin advisory rulings and final determinations under 19 C.F.R. 177.21 *et seq*. (19 U.S.C. § 2511 *et seq.*).

[2] The comment period for the proposed rule ended on September 23, 2008.

[3] *Anheuser-Busch Brewing Assoc. v. United States*, 207 U.S. 556, 562 (1908) (quoting *Hartranft v. Wiegmann*, 121 U.S. 609, 615 (1887)); *see also*, *Belcrest Linens v. United States*, 741 F.2d 1368 (Fed. Cir. 1984).

[4] 19 C.F.R. 102.11(a).

[5] Classifications are harmonized internationally at the subheading level, but countries may classify goods at even lower levels, e.g., tariff items.

[6] *See* 19 C.F.R. 102.20. The applicable tariff shift rule states that "a change to heading 1701 through 1702 from any other chapter" satisfies the rule. Since sugar is classified under the same chapter as the drink mix, the tariff shift rule has not been satisfied.

[7] In this case, the very next step in the process states that the country of origin of the good is the country or countries of origin of the single materials that imparts the essential character to the good, 19 C.F.R. 102.11(b), which is the non-originating sugar.

[8]Based on its own experience, CBP identified five specific product areas in which the outcomes of the codified and case-by-case methods for determining origin have been inconsistent.