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Recent US Customs developments in determining the proper boundaries of tariff engineering

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This article analyses the general boundaries of tariff engineering using a current classification dispute involving the importation of "wickless wax objects" from China into America, as well as other tariff disputes, as examples.

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I. Introduction

Understandably the recently filed petition, under 19 U.S.C. 1516, on behalf of the National Candle Association (NCA) to challenge the tariff classification of certain imported wax items may have gone unnoticed.[1] On its surface this specific development may appear as germane to the general importing community as seventeenth century French philosopher René Descartes' famous wax argument is relevant to the tariff classification of candles today. However, this controversy raises important issues concerning the boundaries of "tariff engineering", the importer's right to fashion its imported products under the legal precedent established by the United States Supreme Court's decision in *Merritt v. Welsh*[2], and its progeny; the United States Customs and Border Protection's (US Customs) willingness to revoke or modify previously issued rulings upon which importers have relied; the potential deleterious impact that the alleged circumvention of anti–dumping orders may have on specific domestic industries (and on the aforementioned legal precedent); and the level of judicial deference entitled to US Customs' tariff classification decisions, determinations that are generally wrought with subjectivity. These significant issues are reminiscent of the *Heartland* sugar controversy of the 1990s, and thus the matter should be of interest to importers and international trade practitioners irrespective of their level of involvement with the candle industry.

II. The Classification Dispute

A. The NCA's complaint

The NCA is requesting that US Customs reconsider its classification of imported wickless wax objects from China. These products are allegedly being classified in a manner that circumvents a standing anti–dumping order placed on imported petroleum wax candles from China to protect the domestic candle industry from material economic injury.[3]The anti–dumping order (A-570-504), and corresponding additional anti-dumping duties (at the general rate of 108.30 percent), generally apply to candles classified under Heading 3406 of the Harmonised Tariff System of the United States (HTSUS), which provides for "candles, tapers and the like," although the HTSUS subheading is not dispositive of the order's scope.

However, in over a dozen written rulings in the past decade, US Customs has classified wickless wax objects in HTSUS Heading 9602 because they do not meet the common definition of a "candle" of Heading 3406.[4]Historically, candles classifiable in Heading

3406, or its predecessor Tariff System of the United States Item 755.25, require the existence of a wick surrounded by a body of wax capable of providing illumination. Heading 9602 generally provides inter alia for "molded and carved articles of wax . . . not elsewhere specified or included." The NCA is petitioning US Customs to reclassify these imported wickless objects under HTSUS Heading 3406, which may arguably subject them to the aforementioned anti–dumping order (although the HTSUS Subheading is merely a convenient guide; it is the written product description in the anti–dumping order that is dispositive).

The imported wickless wax objects, presently classified in Heading 9602, generally vary in shape, color, scent and size but typically have the common characteristics of being relatively small, generally under 12 inches in height, and in many cases have a small hole, generally a quarter of an inch wide, drilled through the centre from top to bottom, clearly suitable for housing a candle wick. However, the imported wax objects do not contain wicks, as the wicks are allegedly inserted after importation into the United States.

Before jumping to the conclusion that the wickless wax objects at the centre of this controversy are clearly classifiable as unfinished "candles," remember Descartes' philosophical conclusion that the human senses are not useful in acquiring knowledge about physical things (ironically derived through his observations of the mutable physical properties of wax, over three centuries ago). Today, Descartes' observation would seem fitting in the world of tariff nomenclature where US Customs' technical classifications of imported objects are also not always apparent to the senses. Indeed, classifications must be determined on the basis of often subjective tariff rules and vague descriptions, including but not limited to the HTSUS' General Rules of Interpretation (GRI), the terms of the tariff headings and the relative section or chapter notes. It would appear that the importers of these wickless wax objects have "engineered" their imported items to avoid classification in Heading 3406. However, this fact in and of itself should not dictate classification in Heading 3406 since it is a long standing judicial principle that importers have the right to fashion goods to avoid the burden of high duties, a practice commonly referred to as "tariff engineering."[5]

B. The *Merritt* decision

In *Merritt*, the Supreme Court announced that tariff engineering is appropriate "so long as no deception is practiced, so long as the goods are truly invoiced and freely and honestly exposed to the officers of customs for their examination, no fraud is committed, no penalty is incurred."

A decade later the Supreme Court annunciated a similar principle that, absent a "use" provision, goods are to be classified in their condition as imported.[6] Over the next century the courts have decided various classification cases on the basis of *Merritt* and its progeny, going as far as stating that the importer's reasons or motivation for modifying the imported product is immaterial to the proper classification.[7] Thus, importers today maintain the right to import an unfinished product in a condition that draws the lowest rate of duty.

III. The *Heartland* sugar controversy

A. Limiting the *Merritt* principle

However, as mentioned, there are limitations to the *Merritt* principle. US Customs has on various occasions distinguished between "legitimate" tariff engineering and mere "disguise or artifice" intended to escape a higher rate of duty. In the *Heartland* sugar controversy of the 1990s, US Customs revoked a previously issued classification ruling concerning the importation of certain sugar syrups, reasoning that the product was a mere "disguise or artifice" because the importer did not disclose that the substance it proposed to import allegedly had no commercial identity, nor legitimate commercial purpose.[8]

By way of background, the importer, Heartland By-Products Inc (Heartland), had obtained a "binding" classification ruling in 1995 for imported sugar syrup, essentially a mixture of sugar, molasses and water. US Customs initially classified the product in HTSUS Subheading 1702.90.40, providing generally for sugar syrups containing *more than 6 percent* of soluble non-sugar solids by weight (excluding "foreign substances"), dutiable at a rate 0.7 cents per litre. Heartland's inclusion of molasses in the mixture ensured the imported syrup exceeded the requisite 6 percent of soluble non-sugar solids, essentially avoiding classification in Subheading 1702.90.10/20 which would have subjected the imported syrup to the tariff rate quota (TRQ) that was in place to protect domestic sugar producers (i.e., once the annual quantitative import limitation was reached, a much higher general duty rate of 41 cents per kilogram became applicable). After importation, however, Heartland removed the molasses so that the residual sugar in the mixture became as commercially saleable as the domestic sugar which was meant to be protected by the TRQ. As a result, two domestic sugar associations petitioned US Customs to revoke Heartland's 1995 ruling, which US Customs eventually did in 1999, notwithstanding that Heartland had purportedly invested US$10 million in its syrup and sugar operations in reliance on the favorable 1995 ruling.

> "there are limitations to the Merritt principle"

B. Upholding the US Customs' interpretation

Heartland successfully overturned the ruling revocation in the Court of International Trade (CIT), with the court heavily relying on the long history of *Merritt* precedent in favor of the importer's right to tariff engineering, but was subsequently reversed by the Federal Circuit Court of Appeals (CAFC) on alternative grounds.[9] The CAFC determined that US Customs' revocation ruling, and reclassification, was entitled to deference under the *Mead* and *Skidmore* standards, and therefore it saw "no reason to disturb Customs' interpretation."[10] With circuitous jurisprudence, the CAFC dodged the issue of whether the importer had crossed the boundaries of permissible tariff engineering. Instead, the CAFC grounded its decision on a finding that deference was owed to US Customs' 1999 epiphany (or reinterpretation) that the legal meaning

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of the term "foreign substances," as used in the relevant tariff, included molasses (whereas that very same term in 1995 apparently did not include molasses). Accordingly, molasses became excludable from the weight calculations of soluble non–sugar solids under the tariff rules, and thus the sugar syrup was recalculated to contain *less than 6 percent* of soluble non-sugar solids, classifiable in Subheading 1702.90.10/20, subject to the TRQ.

Notably between the time of the initial ruling in 1995 and its revocation in 1999 US Customs received letters from 26 US Senators and two US Congressman concerning Heartland's tariff classification ruling. The result was a technical classification victory for US Customs, and a trade policy victory for the domestic sugar industry.

IV. Applying the *Heartland* sugar controversy

Although the *Heartland* controversy was ultimately decided on the basis of US Customs' reinterpretation of the (apparently malleable) legal tariff term "foreign substances", it is worth noting that the crux of US Customs' revocation at the agency level was that the importer had crossed the legitimate bounds of the *Merritt* principle by not disclosing that the imported mixture had no commercial identity, nor legitimate commercial purpose. Deftly, this issue was not specifically addressed by the CAFC's majority opinion in *Heartland*, however, Senior Circuit Judge Friedman opined in his concurring opinion that US Customs was justified in its legal conclusion that Heartland's importation is mere "disguise or artifice."

Thus, the issue of "legitimate" tariff engineering may arise again in the present matter of imported wickless wax objects. However, unlike *Heartland*, given the observable candle–like characteristics of the imported wax objects in this case, it may be difficult for U.S. Customs to credibly argue that the product was a mere "disguise or artifice" for the true nature of the ultimate product. This may be a situation even Descartes would find difficult to disagree that the senses are indeed useful.

V. Conclusion

Interested parties have an opportunity to submit comments to US Customs until March 8, 2010, concerning the correctness of the current classification of the wickless wax object.[11] Now it is up to US Customs to determine the appropriate course for this matter. It is well established that US Customs has the authority to correct, modify or revoke classification decisions pursuant to its authority under 19 U.S.C. 1516 or 1625. However, equity demands that this authority be exercised sparingly and only with strong textual justification. Notwithstanding the limitations of ruling letters as a general force of law, importers rely on their own and/or customs advisor's good faith understandings of the tariff requirements and HTSUS descriptions, often analysed through US Customs ruling letters, in order to make compliance decisions and business investments. Therefore, irrespective of what US Customs ultimately decides on this classification controversy, it should resist arbitrarily contorting tariff classification terms, rules or established legal precedent merely to satisfy the trade policy objectives *du jour*, as this erodes confidence in the agency's classification decisions that often serve as the basis for the importing public's compliance efforts.

There may indeed exist other legitimate domestic, political or trade policy interests at stake in any particular tariff classification dispute (and arguably other appropriate administrative or legal avenues in which to address these non-classification issues, e.g., an anti–dumping circumvention action under 19 U.S.C. 1677j, or an anti–dumping scope modification request, etc), however the gravity of these interests should not steer US Customs essential classification function away from accurately determining the tariff nomenclature of imported goods. Otherwise US Customs tariff pronouncements may become as illuminating to the compliance community as a candle without a wick.

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NOTES

[1] 75 FR 420 (January 5, 2010)

[2] 104 U.S. 694 (1881)

[3] 51 FR 30686 (August 28, 1986

[4] US Customs Rulings NY L8538 (June 15, 2005), NY E87727 (Sept. 27, 1999) and HQ 066171 (August 29, 1980)

[5] *Merritt v. Welsh*,104 U.S. 694 (1881)

[6] *Worthington v. Robbins* ,139 U.S. 337 (1891).

[7] *Robert G. Lynch Co. v. United States*, 49 C.C.P.A. 74 (1962); See also *United States v. Citroen*,223 U.S. 407 (1912) (the Supreme Court classified imported pearls with drilled holes, unset and unstrung, but held together by string, under the tariff for "pearls in their natural state, not strung or set," dutiable at 10 percent, as opposed to the tariff classification for jewelry, including "pearls set or strung," dutiable at 60 percent).

[8] 33 Cust. Bull. No. 35/36 (September 8, 1999); HQ Ruling 961273 (August. 25 1999), revoking Ruling NY 810328 (May 15, 1995).

[9] *Heartland By-Products, Inc v. United States,* 23 C.I.T. 754 (1999), revised, 264 F.3d 1126 (Fed. Cir. 2001), cert. denied, 537 U.S. 812 (2002)

[10] *United States v. Mead Corp* ,121 S. Ct. 2164 (2001) (US Customs' classification letter rulings are not entitled to *Chevron* deference, but are eligible for deferential "respect proportional to its power to persuade")

[11] 75 FR 420 (January 5, 2010)

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