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Proposed amendments to U.S. Customs and Border Protection regulations regarding non-preferential origin determinations for merchandise imported from Canada or Mexico

On July 6, 2021, U.S. Customs and Border Protection (CBP) proposed amendments to its regulations regarding non-preferential origin determinations for merchandise imported from Canada or Mexico. The proposed rule would apply the North America Free Trade Agreement (NAFTA) marking rules with respect to country of origin determinations, previously applicable solely to marking determinations and broadly apply such rules to country of origin determinations for purposes of duty calculations (including, for example, assessment of Section 301 tariffs for products from China), U.S. government procurement, admissibility and quotas. While the NAFTA Implementation Act was repealed by the United States-Mexico-Canada Trade Agreement (USMCA) Act as of July 1, 2020, the USMCA addresses only the classification for the purposes of tariff determinations and does not address the marking requirement. Therefore, the CBP continued to use the NAFTA marking rule for the purpose of determining the country of origins requirement even after the USMCA came into effect.

This proposed rulemaking would change the U.S. regulatory scheme through which country of origin is determined, with the potential for a significant long-term impact on companies importing merchandise from Canada or Mexico. Companies should assess both the potential impact of these proposed rules on their current country of origin determinations as

well as future strategic decisions regarding their location of manufacturing, selection of suppliers and other aspects of their international supply chain, with a particular emphasis on identifying impacts on Section 301 tariffs for products from China.

Background: What is country of origin?

The country of origin of merchandise determines the rate of duty, admissibility, quota, eligibility for procurement by government agencies and marking requirements. As a general matter, the CBP uses a "substantial transformation" standard to "determine the country of origin of goods for non-preferential purposes." However, things are a bit more complicated for merchandise imported from Canada or Mexico for non-preferential purposes, as the CBP uses two different methods in determining whether manufacturing operations have resulted in a substantial transformation: the traditional substantial transformation test and NAFTA marking rules.

Current country of origin tests for products from Canada or Mexico: Substantial transformation vs. tariff shift

Duty assessment: Substantial transformation test

For products imported into the U.S. from Canada or Mexico, the CBP uses the traditional "substantial transformation" test for the purpose of determining duty assessment (such as whether certain products would be assessed Section 301 tariffs for products from China), eligibility for government procurement under the Buy American Act, admissibility and quotas.

Under the standard, for a substantial transformation to occur, "a new and different article must emerge, 'having a distinctive name, character or use.'" When a product is produced in one country from components or materials sourced from multiple countries, the country of origin will be where the product was last substantially transformed. This traditional substantial transformation test is a subjective test, and requires a fact-intensive, case-by-case analysis applying judicial opinions and administrative rulings.

NAFTA marking rules: Tariff shift

On the other hand, the CBP uses the NAFTA marking rules, codified in CBP regulations, to determine the proper country of origin marking for non-textile products imported from Canada or Mexico (whether the product can be marked as "made in Canada" or "made in Mexico"). Under these rules, a product can be marked as made in Canada or Mexico if each non-originating (not of Canadian or Mexican origin) components used in the production of that product meets the requirements of the tariff shift test (i.e., a change in classification, unless a de minimis or other exception applies).

Currently, the two different rules noted above (substantial transformation and tariff shift) may result in different country of origin determinations for

purposes of marking and duty assessment for the same goods. In one famous case, Headquarter Ruling Letter (HQ) H300226 (Sep. 13, 2018), in determining the country of origin for certain brushed electric motors produced in Mexico, the CBP contended that the assembly operation in Mexico was insufficient to constitute substantial transformation under the traditional substantial transformation test, but was sufficient to constitute substantial transformation under the NAFTA marking rules. Therefore, the motors could be marked as "made in Mexico," but the importer still had to pay the applicable Section 301 tariffs as those products imported from Mexico remained products with the country of origin of China.

Application of the proposed rule

The proposed amendments would apply the NAFTA marking rules consistently to all non-preferential origin determinations that the CBP makes for merchandise imported from Canada and Mexico. This would limit the possibility of a product having one country of origin for marking purposes (under the NAFTA marking rules) and a different origin for other non-preferential purposes (under the traditional substantial transformation test).

The CBP contends that expanding the NAFTA marking rules "will provide continuity for the importing community" as these rules have been in effect since 1994, and the importing community has made "extensive efforts to comply" with the rules. Additionally, the NAFTA marking rules are codified and more standardized for determining country of origin. In contrast, the traditional substantial transformation test is subjective in nature and yields a significant degree of uncertainty.

How companies may be impacted

Greater consistency in country of origin determinations

If these proposed amendments are adopted, products that are imported into the U.S. from Canada or Mexico that currently have two different origins will have only one country of origin pursuant to the NAFTA marking rules.

In the context of the U.S. and China trade disputes, the proposed rule would be significant for companies' efforts to diversify their supply chains and to move certain manufacturing operations from China to other countries in order to reduce exposure to possible Section 301 tariffs. The proposed rule would potentially make Canada or Mexico more attractive locations for Chinese companies to establish manufacturing operations, as it could be easier to satisfy the tariff shift standard to establish Mexican or Canadian origin for duty assessment purposes under the NAFTA marking rules, versus the traditional substantial transformation test.

For example, materials processed in countries other than Mexico or Canada (such as Vietnam, another popular destination as companies shift

manufacturing facilities out of China) may not be sufficiently modified to qualify as "made in Vietnam" for Section 301 tariff purposes, but the same materials with the same processing in Mexico or Canada may be sufficient to satisfy a tariff shift rule under the NAFTA marking rules to qualify as "made in Mexico" for Section 301 tariff purposes.

The more objective nature of the NAFTA marking rules would also add more predictability for companies to decide the level of non-Chinese processing required in order to satisfy the substantial transformation test, which is important as they diversify their supply chains and move all or some of their manufacturing operations out of China.

Note that previous CBP decisions that have resulted in two country of origin determinations for products imported from Canada or Mexico, such as HQ H300226, may be revoked if the new regulations go into effect. Therefore, companies negatively affected by the prior CBP rulings should also consider filing a comment in support of the proposed rule, as they would benefit from having the country of origin be designated as Canada or Mexico, and thus, avoid the need to have to pay Section 301 tariffs.

Potential expansion of eligibility for U.S. government procurement

The proposed rule may make it easier for products imported from Canada or Mexico to have a country of origin determination to be in Canada or Mexico, making them potentially eligible for government procurement. While the Buy American Act generally requires goods procured for public use be produced in the U.S., Canadian and Mexico suppliers are largely exempt from these requirements as a result of U.S. international commitments under the NAFTA Chapter 10 and the World Trade Organization Government Procurement Agreement. Therefore, the proposed rule may potentially increase the eligible products or companies to participate in government procurement. However, it should be noted that the Buy American rules are constantly changing, and a company may not necessarily be eligible for government procurement because the products would have a country of origin in Canada or Mexico. To learn more about the Buy American rule under the Biden Administration, read the previous *Porter Wright Law Alert*, "Reevaluating your supply chain: How the new American-made product qualifications rule may impact your business."

Opportunity to advocate for more consistency in country of origin determinations

The proposed rule may also present an opportunity to comment on and advocate for changes in the traditional subjective substantial transformation rule for non-NAFTA countries to the NAFTA marking rules or a more objective substantial transformation test for country of origin determinations. The CBP itself has acknowledged some longstanding problems with the traditional subjective substantial transformation test, yet it continues to apply the test for nearly all non-preferential origin determinations. The trade communities wishing for a more objective

standard may want to consider taking this as an opportunity to advocate for the change.

Conclusion and recommendations

In conclusion, the proposed amendments would eliminate inconsistency for non-preferential origin determinations for merchandise imported from Canada or Mexico. By enforcing the NAFTA marking rules rather than applying two different country of origin tests, the rules will be more uniform and produce more consistent results. The proposed amendments may potentially make it easier for products produced in Canada or Mexico to qualify as "made in Canada" or "made in Mexico" for duty assessment purposes, making Canada and Mexico more popular destinations as companies seek to diversify their supply chains and move certain manufacturing out of China (particularly for the purpose of avoiding Section 301 tariffs).

Companies negatively affected by prior CBP rulings regarding country of origin, companies that are considering diversifying their supply chains and moving certain manufacturing out of China, and any company that could benefit from increased consistency in country of origin rulings should consider filing comments before the Aug. 5, 2021 deadline, so they may increase their chance to benefit from the proposed rule changes.

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