

PwC Tax – Supply Chain Transformation

Section 301 Duty Mitigation Strategies

The United States Government has imposed additional customs duties on approximately \$370 billion worth of Chinese products when imported into the United States, under authority of section 301 of the Trade Act of 1974, 19 U.S.C. §2411 ("Section 301"). China located manufacturers are looking for ways to remain competitive, we list some strategies that can be used in collaboration with your customers which may be able to mitigate the effect of those section 301 duties on goods imported into the United States.



Section 301 Duty Mitigation Strategies

Product classification analysis

Product exclusion process

Alternative sources of supply

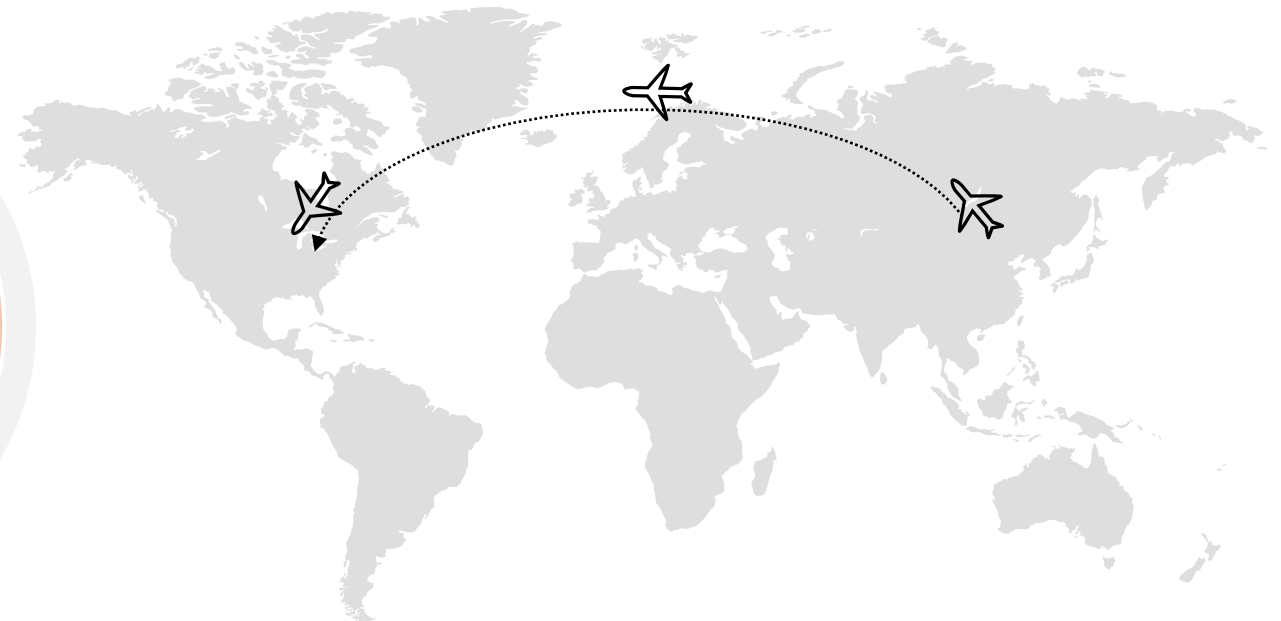
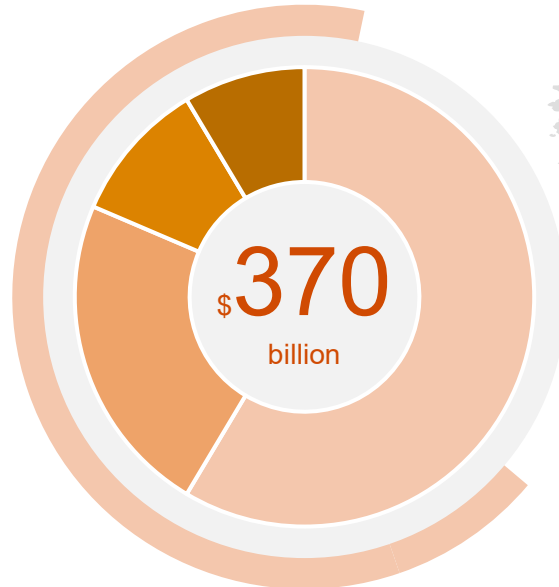
Third country assembly

Valuation on the Basis of the First Sale for Export to the US

9802.00.80 duty preference

Duty Drawback on Products Imported from China and Subsequently Exported

Although approximately \$370 billion worth of Chinese products are now subject to Section 301 duties, there are many Chinese products, imported into the United States, that are **not** subject to those Section 301 duties. The products that are subject to the Section 301 duties are identified by 6 digit HTSUS number in the Annexes to the various **Federal Register** notices imposing those Section 301 duties. Accordingly, importers that believe that the products that they import from China may be subject to Section 301 duties should review the classification for United States Customs purposes of those products. At least for some companies that import products from China which heretofore have been eligible for duty-free importation into the United States (i.e., zero rated), as a practical matter those products may not have been subject to a rigorous and detailed customs classification analysis. In those circumstances, importers may be well advised to reconsider the classification of the imported products in question, as reclassification, if warranted, may result in moving the imported products into a HTSUS subheading that is not currently subject to Section 301 duties.



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In imposing the Section 301 duties on products imported from China, the USTR created a process by which importers and other interested parties could petition for the exclusion of their specific products from those Section 301 duties. The Federal Register notices establishing the procedures for submitting product exclusion petitions identify the following factors that will be considered by the USTR in making decisions to grant or deny those petitions.



- Whether the product is available only from China, or whether there are comparable products available in the United States or from third countries.
- Whether the imposition of additional duties on the particular product would cause severe economic harm to the particular importer requesting exclusion or to other United States interests.
- Whether the particular product is strategically important or related to the "Made in China 2025" Chinese Government industrial program.
- The ability of U.S. Customs & Border Protection ("CBP") to administer the exclusion of the particular product.⁵

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The Section 301 duties apply to those products for which China is the country of origin, under United States country of origin marking rules. A stated objective of United States trade policy officials is to reduce supply chain dependence on China, and throughout the public hearings conducted by the USTR on the imposition of Section 301 duties, questions posed by USTR officials to importers were focused especially on the following:



Are the products that you currently import from China available from sources in countries other than China?



How difficult would it be, and how long would it take, for you to shift the manufacture and/or procurement of the products that you currently import from China to another location outside of China?

Thus, if a United States importer can shift its source of supply of products from a vendor in China to a vendor located in another country, the Section 301 duties may become moot. It must, however, be emphasized that the products procured from a third country source must, in fact, qualify as products of that third country (or some country other than China) to be outside of the scope of the Section 301 duties. Transshipping Chinese origin products through a third country, or shipping products to a third country for processing that amounts to no more than "simple assembly" will not be sufficient to change the country of origin of those products.

In those circumstances, even if the products are shipped from the third country directly to the United States, the products must be marked and declared as "products of China", and, if included on one of the lists of sanctioned Chinese products, they will be subject to the Section 301 duties when imported into the United States

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United States companies that import from China complex products assembled from a variety of parts, components, materials and subassemblies should consider the possibility of performing (or having performed) final assembly of those complex products in a third country. If the final assembly operations performed in the third country are sufficient to constitute a “substantial transformation” of the Chinese origin parts, components, materials and/or subassemblies from which the final product is assembled, then the country of origin of the final product will be that third country, and the Section 301 duties will not be applicable (even if the majority of the parts, components, etc. used in the final product are of Chinese origin).

The CBP Regulations, provides that the “country of origin “of an imported product: means the country of manufacture, production or growth of any article of foreign origin entering the United States. Further work or material added to an article in another country must effect a substantial transformation to render such other country the country of origin.

In pursuing this Section 301 duty mitigation strategy, the critical issue is whether the assembly or processing activity in the third country is sufficient to constitute a "substantial transformation" of that product. A product assembled from various parts and components will be deemed to have undergone a “substantial transformation” if, as a result of a manufacturing or assembly process, it has been transformed into a new and different article of commerce with a name, character or use distinct from that of the parts and components from which it was so transformed.

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Duty Drawback on Products Imported from China and Subsequently Exported

The primary method for determining the value for Customs purposes of imported goods is the "transaction value". The transaction value of imported goods is the actual price paid or payable for the goods when it is sold for exportation to the United States (subject to certain statutory adjustments). In most instances, that price is the total amount paid or payable by the United States importer to the foreign seller for the goods.

In a multi-tier procurement structure, however, it may be possible to reduce the customs value of goods imported from China, and therefore the amount that will be subject to Section 301 duties, based on the "first sale for export". The opportunity to mitigate the effect of the Section 301 duties on imported Chinese goods may therefore arise in circumstances in which a Chinese manufacturer sells the goods to an intermediary in a third country, and that intermediary resells the goods to the United States importer. In those circumstances, the manufacturer's price of sale to the intermediary, rather than the intermediary's higher resale price to the United States importer, may constitute a bona fide transaction value for United States customs purposes when the goods are imported into the United States⁹.

In a General Notice, published as T.D. 96-87 (December 13, 1996), CBP identified the following three conditions which must be satisfied in order for an importer to declare the value of imported goods for customs purposes on the basis of the price of sale of that goods from the foreign manufacturer to a third country intermediary:



There must be a bona fide sale of the goods by the manufacturer to the intermediary.



The manufacturer and the intermediary must deal with each other with respect to the purchase and sale of the goods at "arm's length".



At the time of the sales transaction between the manufacturer and the intermediary, the goods must be clearly destined (irrevocably committed) to exportation to the United States.

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Subheading 9802.00.80, HTSUS establishes a special duty preference for certain imported goods assembled abroad from United States origin fabricated components. Ad valorem duties on imported products that meet the requirements of subheading 9802.00.80 are assessed on the full customs value of those imported products, less the value of the United States origin components. Subheading 9802.00.80, HTSUS may, therefore, provide some Section 301 duty mitigation for products assembled in China from United States origin components that meet the requirements of that United States tariff provision and the implementing provisions of the CBP Regulations.

The duty preference of subheading 9802.00.80, HTSUS is implemented by section 10.13 of the CBP Regulations, which identifies the following conditions for qualification of goods assembled abroad for the duty preference when imported into the United States.



The United States origin fabricated components must be in condition ready for assembly without further fabrication at the time of exportation from the United States.

The fabricated components may not lose their physical identity through the assembly process.

The fabricated components have not been advanced in value or improved in condition abroad, except (i) by the assembly process; and (ii) by operations incidental to the assembly process

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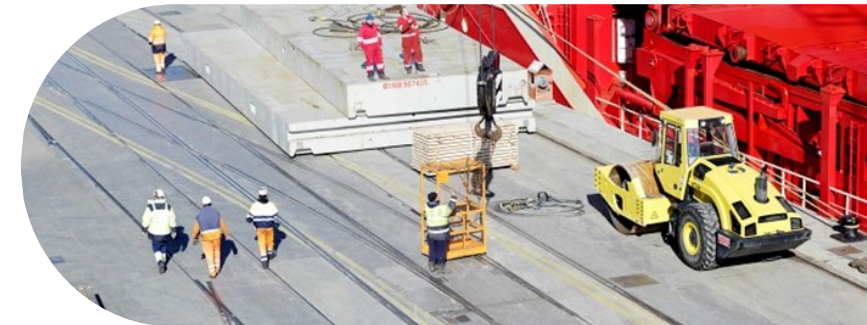
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The duty preference is, therefore, only available when the United States origin fabricated components are "assembled" abroad. The concept of such "assembly" is defined as the joining or fitting together of solid components, and may include welding, soldering, riveting, force fitting, gluing, laminating, sewing or the use of fasteners. Products assembled abroad will not be disqualified from the duty preference of subheading 9802.00.80, HTSUS if they are subject to "operations incidental to assembly", CBP Regulations, identifies the following activities as "operations incidental to assembly":

- 1 cleaning
- 2 removal of rust, grease, paint or other preservative coating
- 3 application of paint or preservative coating, including preservative metallic coating, lubricants, or protective encapsulation
- 4 trimming, filing or cutting off of small amounts of excess materials
- 5 adjustments in the shape or form of a component to the extent required by the assembly being performed abroad
- 6 cutting to length of wire, thread, tape, foil, and similar products exported in continuous length; separation by cutting of finished components, such as pre-stamped integrated circuit lead frames exported in multiple unit strips
- 7 final calibration, testing, marking, sorting, pressing, and folding assembled articles

If products assembled in China from United States origin fabricated components meet the above conditions, and therefore qualify for the duty preference of subheading 9802.00.80, then the dutiable value of the products (which may be subject to the Section 301 duties) when imported into the United States, will be: (i) the full customs value of the products (i.e., the price paid or payable when sold for exportation to the United States); less (ii) the cost or value of the United States origin fabricated components. The cost or value of the United States origin fabricated components is either (i) the price paid or payable for those components, f.o.b. United States port of exportation; or (ii) if the components are not sold, the value of those components at the time of export shipment from the United States.



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Section 313 of the Tariff Act of 1930, and Part 191 of the CBP Regulations, 19 authorize the drawback of duties paid on importation of goods into the United States when that goods is subsequently exported either:

- i as incorporated into products manufactured in the United States (i.e., manufacturing drawback); or
- ii in the same condition as originally imported (i.e., unused goods or same condition drawback).

The drawback statute allows the recovery of 99 percent of the duties originally paid on the imported goods, when the goods are subsequently exported, subject to the various conditions and requirements of the CBP Regulations.



Conclusion

- The imposition of Section 301 duties on a huge volume of goods exported from China presents enormous financial and compliance challenges for Chinese companies and their United States customers that rely upon them as key elements of their supply chains.
- Our supply chain transformation experts can help you to possibly mitigate the impact of those Section 301 duties by means of carefully analysis of existing and potential supply chains and consideration of how any or all of the foregoing mitigation strategies might be applied to your manufacturing and procurement operations.

