

ORIGIN AND PREFERENCES

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This memorandum provides a summary analysis of the rules of origin and the rules governing eligibility for various tariff preferences.

I. Origin

Origin is a concept of major significance in the administration of the customs and trade laws. Most tariff and non-tariff restrictions are based on country of origin. Duty rates, eligibility for tariff preferences, applicability of quantitative restrictions, license and visa requirements, and marking requirements all begin with the determination of the country of origin of an imported product. Where the imported product is from a single country, the determination presents no difficulty. However, where the imported product contains materials, components or ingredients from more than one country, the determination of origin can involve a high degree of complexity.

Generally, where more than one country contributes to the production of an imported product, the country of origin for tariff purposes is the country in which it last underwent a substantial transformation.

The traditional understanding of substantial transformation is that it occurs when an article emerges from a manufacturing process with a name, character or use that differs from those of the original materials subjected to the processing. Court decisions on the issue of substantial transformation have added an important addendum to this rule. The current rule requires that the processing involved be significant or that it add significant value to the product. Under the existing rule, processing which creates an article having a new name, use or character, or which converts producer goods¹ to consumer goods, will be considered to be substantially transformed provided that the processing is neither negligible nor insignificant and adds significant value when compared to the prior processing.

The court decisions have emphasized that the facts of each case must be examined and evaluated on its own merits. In making this evaluation, one or more of the following criteria, as well as others, may come into play: 1) whether the article had any utility prior to processing; 2) whether the article takes on new characteristics, properties or uses after the processing; 3) whether it takes on a new commercial designation; 4) whether the article is described by a new tariff classification after

¹ Customs and Border Protection ("CBP") usually ignores this factor.

processing; 5) whether the article has been physically transformed; 6) whether the cost of the processing is equal to or greater than the cost of any prior processing; 7) whether the processing takes a shorter or longer period than previous processing; and 8) whether the processing involves a greater or lesser level of technology than the previous processing. Once these criteria are evaluated in connection with a particular imported product, it should be possible to determine whether the particular processing will be deemed to effect a substantial transformation.

A change from materials, *e.g.* leather to footwear, is a substantial transformation as is a change from footwear parts, *e.g.* soles or uppers not formed, to complete footwear. However, a change from formed uppers or duck-type bottoms to complete footwear is not treated as a substantial transformation.

The non-preference, or marking, rules of origin under the North American Free Trade Agreement ("NAFTA") are based on classification principles. Under these rules, which are codified in Section 102.20 of the Customs Regulations, substantial transformation occurs when processing results in a specified change in tariff classification. In the case of footwear, a change in classification into headings 6401 through 6405, Harmonized Tariff Schedule of the United States ("HTS"), from outside the group except from formed uppers is recognized as a substantial transformation.

CBP has proposed to scrap the substantial transformation approach in favor of the tariff shift application technique codified in the NAFTA making rules. *73 Federal Register* 34485 (July 25, 2008). In the case of footwear the change, if adopted, will be of little significance. The traditional substantial transformation and tariff shift approaches reach the same practical results in most situations. The tariff shift rule for footwear is "6401-6405 A change to heading 6401 through 6405 from any other heading outside that group, except from formed uppers."

II. PREFERENCE PROGRAMS

The oldest and most comprehensive preference program is the Generalized System of Preferences ("GSP") and the most important is NAFTA. Most subsequent preference programs follow the approach to preference eligibility of one of the two.

A. GSP. (A, A*, A+) Duty-free treatment under GSP is limited to a specific group of countries and a specific group of products. The countries and products are listed in General Note 3(c)(ii), HTS. One can determine whether a particular product is eligible for duty-free treatment under GSP by referring to the rate of duty column labeled "Special". A product eligible for the GSP preference will bear the legend A or A*. The designation A+ means that the product is eligible when it originates in a lesser-developed developing country. In addition, eligibility for duty free treatment under GSP requires that not less than 35 percent of the appraised value of the imported merchandise consist of value added (local materials and direct costs of processing) in the GSP country. It is also necessary that the product be imported into the United States directly from the GSP country.

Footwear is not eligible for the GSP preference; some, but not all, footwear parts are eligible.

The GSP program was renewed effective January 1, 2018 through December 31, 2020.

GSP is structured to provide that as a developing country becomes internationally competitive in a product, GSP status for that product is terminated. Particular products from particular countries are deleted from the GSP list annually. These changes generally take place on July 1. If one desires to rely on duty-free treatment under GSP, one must pay careful attention to these changes.

As noted above, GSP eligibility depends on meeting minimum local content requirements. One important point to keep in mind is that material imported into a beneficiary country may be used to satisfy the local content requirement if the imported material is subjected to a "double substantial transformation". A double substantial transformation occurs when a material is converted to a component in the GSP beneficiary country and further converted by assembly or manufacturing operations into the finished product. Thus, for example, the CBP has ruled that chemicals imported into a GSP beneficiary country to make a so-called "masterbatch" subsequently used in the molding of footwear parts could be included in calculating local content to determine whether the footwear parts were eligible for duty-free treatment under GSP.

B. NAFTA. (CA, MX) Under NAFTA, a product is not eligible for the tariff preference unless it has undergone a requisite change in tariff classification in the region. In addition, for some products, including footwear, there is a requirement that the customs value of the product be made up by a minimum amount of materials and direct cost of processing originating in the United States, Mexico and/or Canada.

The general rule for footwear is that a change in classification into Chapter 64 from any other chapter creates an article eligible for the NAFTA preference. At this point, the preference and non-preference rules are parallel. A change within Chapter 64 to subheadings 6401.10 through 6406.10 (footwear, uppers and upper parts) from a subheading outside the group (footwear parts other than uppers and other than upper parts, *e.g.*, outsoles) is acceptable as long as 55 percent of the value is represented by materials and processing of United States, Canada or Mexico origin. The non-preference rule has no value component. Note that a change from uppers, whether or not "formed", to complete footwear is not recognized as conferring preference eligibility. Thus, footwear made in the United States, Canada or Mexico with uppers from a fourth country does not qualify for the NAFTA tariff preference. Under the non-preference rule, a change to complete footwear from open (not formed) uppers confers origin.

C. CAFTA. (P, P+) This preference applies to the Dominican Republic, El Salvador, Guatemala, Honduras, Costa Rica and Nicaragua.

CAFTA provides very substantial benefits for footwear importers. Qualifying footwear is duty free. Duty-free treatment requires that the footwear meet one of two preference rules.

The first, and more restrictive, rule applies to the 19 subheadings set out below.² The preference rule of origin for this footwear is a change in classification from any heading outside

² CAFTA and the other agreements discussed here list subheadings in effect during the negotiations. Accordingly, the subheadings listed in the HST General Notes are those in effect at that time. The following subheadings are the current successors of those listed in the Notes:

6401.10.00	6401.99.60	6402.91.20	6402.91.90	6402.99.90
6401.92.90	6401.99.80	6402.91.26	6402.99.08	6404.11.90

6401 through 6405 (complete footwear) except from subheading 6406.10 (uppers), provided there is a regional value content (“RVC”) of not less than 55 percent under the build-up method. This is the NAFTA rule.

For all other footwear, the preference rule is a change to any subheading of Chapter 64 from any other subheading. This is more liberal than the basic origin rule and, in fact, would permit the use of imported formed uppers. Thus, in theory, footwear assembled in a CAFTA country with formed uppers from the PRC would qualify for the preference although they would be marked “Made in China”.

D. AGOA. (D) GSP preferences apply to footwear that originates in Sub-Saharan Africa. The origin and local content requirements for AGOA are similar to GSP. However, 15 percent of the local content requirement may be satisfied by United States-origin materials. AGOA has been extended through fiscal 2025.

E. Korea. (KR) The agreement with Korea became effective March 15, 2012. Most qualifying footwear became duty-free on that date. The exceptions do not see a duty reduction until 2020 and do not become duty-free until January 2023. The exceptions are the subheadings listed in footnote 3, page 4.

The basic rule of origin is the liberal CAFTA rule – a change in classification to a subheading in Chapter 64 from any other subheading. For the exceptions listed in footnote 3, page 4, the rule is the NAFTA rule – a change in classification from outside 6401 through 6406.10 (complete footwear, Bean boot bottoms and uppers) as long as there is a RVC of 55 percent under the build-up method:

F. Others. The United States has entered into bilateral free trade agreements with Bahrain (BH), Israel (IL), Jordan (JO), Chile (CL), Morocco (MA), Panama (PA), Peru (PE), Singapore (SG) and Colombia (CO). The rules of origin for Bahrain, Israel, Jordan and Morocco follow the GSP approach. Qualifying footwear from most of these countries is Free.

The preference rule of origin in the Peru agreement follows the CAFTA model. All qualifying footwear is duty-free as January 1, 2018.

The Colombian agreement has two rules of origin. The more liberal rule requires a change in classification to any subheading in Chapter 64 from any other subheading and an RVC of 20 percent under the build-up method. These are of course exceptions (the subheadings listed in footnote 3, page 4). The exceptions are subject to the NAFTA rules. Most subheadings became duty free on May 15, 2012. For the exceptions, duty free treatment is staged over a 10-year period. They become duty free in January 2021.

The preference rule of origin in the Chile and Singapore agreements adopts the NAFTA approach with one significant difference: for some footwear, non-originating uppers and upper parts may be used as long as the regional value content requirement is met.

6401.99.10	6401.99.90	6402.91.50	6402.99.33	6404.19.20
6401.99.30	6402.90.10	6402.91.80	6402.99.80	

H. Certificates of Origin. Some but not all preference programs have a specific certificate of origin that must be executed by the exporter or the producer. All programs require that the certificate contain certain minimal information. The required information is: 1) name and address of the importer, exporter, and producer; 2) description of the good; 3) the HTS subheading to at least the sixth digit; 4) preference criterion; 5) the specific invoice number or the period covered; 6) signature; and 7) a certification. As a rule, the certificate need not be submitted at entry. However, the importer must have it in its possession when making the preference claim.

The fact that an importer has the appropriate certificate in hand does not guarantee eligibility for duty-free or reduced-duty treatment. CBP can require that importers establish eligibility for preference programs. Thus, it is important for importers who claim the benefits of any of these preferences to make appropriate inquiry of the foreign producer to ensure that the footwear qualifies and that the producers will be able to document eligibility in the event of an inquiry from CBP.

CBP will request commercial and manufacturing records to confirm eligibility. These documents could include purchase orders and entry documents for imported materials, daily production reports, factory profiles, inspection reports, payroll records and export documentation.

I. Timing of the Claim. Although the claim should be made at entry, post-entry claims are allowed. Importers may use Post-Entry Amendments (“PEA’s”), Post Summary Corrections (“PSC’s”) protests and/or Section 520(d) claims where appropriate.

Section 520(d) claims, which are available in some preference programs only, must be made within a year of entry and may be filed after liquidation. The following preference programs have a 520(d) provision, CAFTA, NAFTA, Chile, Oman, Columbia, Panama, Korea and Peru. If the preference program has a 520(d) provision, it is the only means of making a post-entry claim.

Where the preference program, *e.g.*, GSP and AGOA, does not have a 520(d) provision, any of the other post-entry procedures are available.