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## Austin Trade Compliance Roundtable

# Country of Origin Determination/Certificates of Origin - -

## *Legal Issues & Consequences*

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# Country of Origin

- Country of Origin determinations for goods/products may affect duty rate, but it's only 1 factor of many ...
  - Availability of special programs
  - Admissibility & enforcement of government policies & programs
  - Applicability of quantitative provisions (quotas)
  - Application of anti-dumping/countervailing duties
  - Statistical reporting purposes
  - Government procurement
  - Marking requirements

# Country of Origin Marking

- Marking Rules of Origin
  - 19 U.S.C. 1304 – Marking Requirement
  - 19 CFR 134
  - 19 CFR 102
- But also, other agencies also enforce origin marking requirement:
  - Under Sections 42 and 43 of the Trademark Act of 1946 (15 U.S.C. 1124), no good/product of foreign origin that bears a name or mark calculated to induce the public to believe it was manufactured in the U.S. or any foreign country/location other than the country/location where it was actually manufactured is admissible.
  - Imported goods/products bearing a prohibited name or mark under Section 42 are subject to seizure and forfeiture.

# Country of Origin Rules

- Though determination of country of origin may be simple & straightforward, when finished product's component parts originate in many countries, determining origin can be complex & time-consuming.
- Country of Origin Rules:
  - Non-preferential (apply to goods/products originating in countries with which the U.S. has most-favored-nation (MFN) status in absence of multi-lateral or bilateral trade agreements)
    - As a member of WTO, U.S. must grant immediate & unconditional MFN treatment to products of other members with respect to tariffs and other trade-related measures (2 countries NOT afforded MFN status: Cuba & North Korea)
  - Preferential (e.g. rules applied to determine eligibility for special treatment under trade agreements or special legislation)

# Country of Origin Rules

- No specific U.S. statute prescribing rules; instead found in CBP regulations & legal precedent. Gives CBP latitude in determining origin – which some say leads to subjective and unpredictable determination.
- For ex: “substantial transformation” analysis requires consideration of:
  - Character/name/use of new article
    - Question: What qualifies as a “new” article?
  - Nature of manufacturing process compared to process used to make imported parts/components/other materials
    - Recurrent issue: What processes or procedures are sufficient?
  - Amount of value added by manufacturing process (& cost of product, amount of capital investment or labor required) compared to value imparted to final article by imported parts/components/other materials
    - Challenge: sufficient tracking and documentation of corresponding values
  - Whether essential character of article is established by manufacturing process in country or by essential character of the imported parts/components/materials
    - Recurrent issue: What is essential character of each?

# Country of Origin Rules

- Both non-preferential and preferential rules use “wholly obtained” criterion (i.e., wholly the growth, product or manufacture of a particular country) – but:
- Non-preferential rules utilize “substantial transformation” criterion – defined in most cases as last place in which item substantially transformed into a ***new, distinct article of commerce base on change in value, character or use.***
- Preferential rules can be very detailed & specific, varying from agreement to agreement: e.g.
  - NAFTA rules 19 C.F.R. 102 using tariff shift method (under Harmonized Tariff Schedule or HTS) as a result of production in one or more of NAFTA countries
  - Required in-country specific processing operations
  - Local content (minimum percentage of domestic value-added (i.e. component or manufacturing process) in the country in order to confer origin/tariff benefit
    - Most FTA’s and preference programs contain this requirement but amount of local content may vary among FTA’s ***and from product to product within same the FTA***

# Ex: NAFTA's General Preferential Rules

## 19 CFR 102.11 General rules.

The following rules shall apply for purposes of determining the country of origin of imported goods other than textile and apparel products covered by §102.21.

- (a) The country of origin of a 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 that good undergoes an applicable change in tariff classification set out in §102.20 and satisfies any other applicable requirements of that section, and all other applicable requirements of these rules are satisfied.
- (b) Except for a good that is specifically described in the Harmonized System as a set, or is classified as a set pursuant to General Rule of Interpretation 3, where the country of origin cannot be determined under paragraph (a) of this section:
  - (1) The country of origin of the good is the country or countries of origin of the single material that imparts the essential character to the good, or
  - (2) If the material that imparts the essential character to the good is fungible, has been commingled, and direct physical identification of the origin of the commingled material is not practical, the country or countries of origin may be determined on the basis of an inventory management method provided under the appendix to part 181 of this chapter.
- (c) Where the country of origin cannot be determined under paragraph (a) or (b) of this section and the good is specifically described in the Harmonized System as a set or mixture, or classified as a set, mixture or composite good pursuant to General Rule of Interpretation 3, the country of origin of the good is the country or countries of origin of all materials that merit equal consideration for determining the essential character of the good.
- (d) Where the country of origin of a good cannot be determined under paragraph (a), (b) or (c) of this section, the country of origin of the good shall be determined as follows:
  - (1) If the good was produced only as a result of minor processing, the country of origin of the good is the country or countries of origin of each material that merits equal consideration for determining the essential character of the good;
  - (2) If the good was produced by simple assembly and the assembled parts that merit equal consideration for determining the essential character of the good are from the same country, the country of origin of the good is the country of origin of those parts; or
  - (3) If the country of origin of the good cannot be determined under paragraph (d)(1) or (d)(2) of this section, the country of origin of the good is the last country in which the good underwent production.

[T.D. 96–48, 61 FR 28956, June 6, 1996]

# Country of Origin Rules

- Proliferation of bilateral & regional FTA's entered into by U.S. – each of which has own detailed/specific preferential rule of origin scheme – inserts inefficiencies, complexities & uncertainties and reliance on CBP's subjective and inconsistent interpretation in origin determination process.
- Other problems may exist with FTA rules of origin:
  - Lack of transparency to the inexperienced (e.g., the “triple transformation” rule for apparel products under NAFTA requiring raw materials (i.e., the fiber), the cloth and the garment itself to be processed in the FTA region in order to be eligible for NAFTA treatment)
  - Inconsistent approach to qualifying nature of “assembly processes” under particular preferential rules of origin
- Cost of navigating regulations & compliance may outweigh FTA tariff benefits
  - **But: Just because choose not to avail self of FTA benefits doesn't mean do not have to properly/accurately determine Country of Origin ... other reasons exist for origin determination & exercise of reasonable care and informed compliance of obligations as an importer**

# Areas of Concern

- “Reasonable Care” imposed on importer under Customs Modernization Act (“Mod Act”)
  - Requires an importer of record using reasonable care to transact imports by using reasonable standards and methods to ascertain admissibility and other information necessary to the import process (i.e., classification, valuation, origin, etc.).
- Recordkeeping – Necessary & Adequate
- Legal consequences
  - Civil Penalties
  - Criminal Penalties
  - SOX Penalties

# Civil Penalties

## 19 U.S.C. 1592 PENALTIES

The entry of merchandise by fraud, gross negligence or negligence will subject a company to the following penalties:

- (a) *fraud* – an amount not to exceed the domestic value of the merchandise;
- (b) *gross negligence* – the lesser of the domestic value of the merchandise or four times the lawful duties, taxes and fees owed to the U.S.;
- (c) *negligence* – the lesser of the domestic value of the merchandise or four times the lawful duties, taxes and fees owed to the U.S.

If the violation did not affect the assessment of duties, the penalty for *gross negligence* is 40% of the dutiable value of the merchandise, while the penalty for *negligence* is 20% of the dutiable value of the merchandise.

# Triggers for Civil Penalties

- 19USC1592
  - ***Entry of merchandise by fraud, gross negligence, or negligence*** (including negligent determination of Country of Origin)
  - Valuation, undervaluation, undeclared assists
  - Purposeful misclassification to lower duty rate
  - ***NAFTA failure to qualify, fraudulent claims***
  - American Goods Returned fraudulent claims
  - ***Incorrect marking of country of origin, fraudulent marking***
- Incorrect Country of Origin determination can lead to violations of recordkeeping obligations
  - 19 USC 1509(a)(1)(A) List – 19CFR163.6 requires maintenance of certain records (including entry records – such as NAFTA Certificates of Origin under Part 181.22 & supporting documents)

# Criminal Penalties

- **Negligent or fraudulent Country of Origin determination/reporting can also lead to CRIMINAL PENALTIES**
- In the event of a prior disclosure containing information that gives Customs reason to believe that a criminal violation has occurred, Customs is legally obligated to refer that information to the appropriate U.S. Attorney's office. (Clerical – automatic function)
- Title 18 U.S.C. § 542, provides a maximum of two years' imprisonment, a fine, or both, for each violation involving an importation or attempted importation.
- A conviction under this statute requires proof of five elements:
  - The statement, falsity, materiality, specific intent, and agency jurisdiction.
- Must prove that the link between an act and the deprivation was so direct that the defendant knew or should have known that his or her actions would deprive Government of lawful duties.

# Sarbanes-Oxley

- Sarbanes-Oxley requires top level executives to certify the accuracy of financial statements and the effectiveness of internal controls.
- This includes Import/Export transactions.
- Non-compliance means large penalties if internal controls are inadequate or not in place.
- Controls required for:
  - Tariff Classification
  - Preferential Trade agreements, such as NAFTA
- Government stringently monitors the activities of corporations to protect the interests of shareholders
- Important to **TRACK / REPORT & ADDRESS CORRECTIVE ACTION**

# Best Practices

- Conduct continual training to ensure understanding of importance of country of origin determination and how to conduct.
- Maintain consistent and open communication within the company regarding importance of compliance.
- Conduct periodic audits of country of origin determinations/certificates of origin; document audits.
- Test internal control systems monthly/annually.



# Best Practices

- Maintain an internal database for recordkeeping purposes.
- Develop internal controls for country of origin determination, qualification of goods for trade preferential treatment, & maintenance of supporting documentation.
- Maintain prudent business practices that include vetting of suppliers.

