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News

Customs Changes Approach to Determining Substantial Transformation for Purposes of Country of Origin Declaration

Introduction

For many years, Customs has determined origin of manufactured goods on the basis of whether a "substantial transformation" has taken place during production or assembly, resulting in an article having a "new name, character or use". Historically, Customs has looked at whether assembly is complex and meaningful or minimal/simple as indicative of whether substantial transformation has taken place in the country of assembly. Customs has always said that in doing a substantial transformation analysis, it considers the totality of the circumstances on a case-by-case basis and no single factor is determinative (see e.g. HQ 563110 (Oct. 20, 2004)). However, Customs recently published a Notice of Issuance of Final Determination Concerning Ground Fault Circuit Interrupter, 73 Fed. Reg. 54,420 (Sept. 19, 2008), HQ H030645 (Sept. 15, 2008), which may have implications for the factors that will be considered for a substantial transformation analysis. In that determination, Customs was looking at the origin of ground fault circuit interrupters (GFCIs) to determine origin for the purpose of the government procurement laws. The GFCI subcomponents were all Chinese, including the printed circuit board assembly which was the major component. The subcomponents underwent a 10 minute assembly process in Mexico which included thirty parts and forty-three discrete steps, many of which were testing. Customs held that the GFCIs were of Chinese origin as the assembly processes in Mexico were not sufficiently complex to constitute substantial transformation and thus confer Mexican origin. In making this finding, Customs listed 5 factors: the Chinese origin on the printed circuit board subassembly (which Customs held conferred essential character), that only ten minutes was required for assembly, the assembly process itself was not complicated, many of the steps involved testing, and finally, all of the components were Chinese.

Customs' Previous' Focus on Number of Parts and Assembly Steps Involved

Although Customs has reiterated many times that whether assembly constitutes substantial transformation is very fact-specific, it has looked at the following factors in analyzing whether assembly is complex and meaningful enough to constitute substantial transformation: the number of components assembled, the number of different operations, how time-consuming operations are, skill level required for operations, attention to detail required, value added to the article, overall employment generated by

the manufacturing process, resources expended on product design and development, extent of post-assembly inspection and testing, nature of post-assembly inspection and testing, and origin of components.

While it is true that the above-listed factors have been considered in various rulings as impacting whether substantial transformation has taken place, in many rulings the undeniable focus was on the number of parts assembled and the number of assembly steps required. For example, Customs has noted many times that it has "held in prior rulings that the process of incorporating a large number of discrete components onto a printed circuit board is sufficiently "complex and meaningful" so as to constitute substantial transformation". See, HQ 561463 (Sept. 28, 2001), citing C.D. 85-25, 19 Cust. Bull. 844 (1985). In HQ 563391 (March 10, 2006) Customs noted C.D. 85-25 and held that because circuit breakers were produced by assembling numerous parts and required multiple operations, substantial transformation had taken place. In HQ 563294 (Sept. 9, 2005), Customs ruled on the origin of scanners for government procurement purposes and appeared to focus mainly on the numerous (600) parts involved, and that the scanners were tested and programmed with firmware in the U.S. Likewise, in HQ 562964 (March 29, 2004), Customs focused on the small number of components involved and the minor cost of labor and testing involved in finding that there was no substantial transformation involved in assembly of network tape drive units. In HQ 561232 (April 20, 2004), Customs looked at automotive tuner modules and held that the electronic board module assembly constituted substantial transformation as it was created by attaching in excess of 80 components, plus wave soldering, cleaning, removal of all residual sealant, and testing, and thus was closely analogous to C.D. 85-25.

The Implications of the New Ruling

However, the focus in the aforementioned new ruling HQ H030645 on the short time involved and the Chinese origin of the components, as opposed to the 43 steps involved and the 30 components involved, suggests there may be a subtle but important shift in Customs' approach to substantial transformation. This new approach was also followed in several other recent rulings. In HQ H018467 (Jan. 4, 2008), Customs looked at the origin of multifunction machines for government procurement and gave "substantial weight to the fact that the system control board, engine control board, and the firmware are manufactured in Japan". In HQ W563491 (Feb. 8, 2007), Customs also ruled on the origin of multifunction machines. In the first stage of assembly, some of the subassemblies were assembled in China and some in Japan, while with others assembly began in China and ended in Japan. Subsequently, physical assembly of the models occurred in Japan, adjustment and testing was done in Japan, and there was a final inspection in Japan. Although they said the product assembly was also complex and meaningful, Customs appeared to mostly focus on the origin of the key components in finding that the country of origin was Japan.

Based on these recent rulings, we believe there has now been a change of emphasis in Customs' approach to the

factors involved in determining whether substantial transformation has taken place. It appears that in many instances, Customs may now focus less on the number of the components involved and the number of assembly steps than on the origin of the parts involved, especially major parts, and possibly the length of time it takes to assemble the parts.