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Section 301 Duty Mitigation Strategies

1. Introduction

Between July 6, 2018 and September 24, 2018, the United States Government imposed additional customs duties on approximately $250 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"). Although the intent of those Section 301 duties is to encourage the Chinese Government to abandon certain unreasonable and discriminatory trade practices, which unfairly restrict and burden United States commerce, the practical effect is to raise the cost of Chinese products to United States importers, and ultimately to United States consumers. This paper, therefore, suggests various strategies by which United States importers may be able to mitigate the effect of those section 301 duties on merchandise imported into the United States.

2. Background

Section 301(b) authorizes the United States Trade Representative (the "USTR") to undertake investigations of foreign countries' trade policies, and to take certain "retaliatory actions" where the USTR determines that an act, policy or practice of a foreign country is unreasonable or discriminatory and burdens or restricts United States commerce. Section 301(c) specifies the various actions that the USTR is authorized to take in response to a finding of such an unreasonable or discriminatory trade policy or practice by a foreign country, including the imposition of duties or other import restriction on the goods of that foreign country.

Pursuant to the statutory authority of Section 301, at the direction of the President, on August 18, 2017, the USTR initiated in investigation into certain acts, policies and practices of the Chinese Government related to technology transfer, intellectual property and innovation. Based on that investigation, by a notice published in the April 6, 2018 **Federal Register**, 83 **Fed. Reg**. 14906, the USTR found that the following Chinese Government policies and practices are unreasonable or discriminatory and burden or restrict U.S. commerce, and are, therefore, actionable under Section 301(b):[1]

- China uses foreign ownership restrictions, such as joint venture requirements and foreign equity limitations, and various administrative review and licensing processes, to require or pressure technology transfer from U.S. companies.
- China's regime of technology regulation forces U.S. companies seeking to license technologies to Chinese entities to do so on non-market based terms favorable to Chinese recipients
- China directs and unfairly facilitates the systematic investment in and acquisition of U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property, and generate the transfer of technology to Chinese companies.

[1] The USTR's detailed findings as to China's trade practices and policies are set forth in a report entitled "Findings of the Investigation into China's Acts, Policies and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974," dated March 22, 2018, available on the USTR's website at www.ustr.gov.

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- China conducts and supports unauthorized intrusions into, and theft from, the computer networks of U.S. companies to access their sensitive commercial information and trade secrets.

Based on those findings, the USTR proposed the imposition of additional 25 percent *ad valorem* duties on a list of products, identified by 6 digit tariff classification number on the Harmonized Tariff Schedule of the United States ("HTSUS"), amounting to approximately $34 billion worth of products imported from China into the United States. After publication of that notice, and a public hearing and comment period, the USTR published the final list of products subject to that "first round" of Section 301 duties on June 20, 2018. **See** 83 **Fed. Reg**. 28710. Chinese products included on the final "first round" list became subject to the additional 25 percent *ad valorem* duties when imported on or after July 6, 2018.

The imposition of the Section 301 duties on the Chinese products included on that "first round" list did not result in a change in Chinese Government practices and policies found to be unreasonable and discriminatory in the USTR's investigation[2]. Instead, as part of an escalating "trade war" between the United States and China, the two additional lists of Chinese products have been subject to Section 301 duties. Specifically, a "second round" list of Chinese products, corresponding to approximately $16 billion in imported products, became subject to additional 25 percent *ad valorem* duties on August 23, 2018. A "third round" list of Chinese products, corresponding to approximately $200 billion worth of imports, became subject to additional 10 percent *ad valorem* duties on September 24, 2018[3]. **See** 83 **Fed. Reg**. 40823 (August 16, 2018) and 83 **Fed. Reg**. 47974 (September 21, 2018).

3. Section 301 Duty Mitigation Strategies

(a) **Product Classification Analysis**: Although approximately $250 billion worth of Chinese products are now subject to Section 301 duties (either at the 25 percent rate or the 10 percent rate), there are a large number of Chinese products, corresponding to approximately $267 billion worth of imports into the United States, that are **not** subject to those Section 301 duties. As noted above, 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

[2] To the contrary, in "retaliation" against the United States Government's imposition of those Section 301 duties on Chinese products, the Chinese Government imposed corresponding additional duties on a comparable volume (by value) of products imported into China from the United States.

[3] The Section 301 duties on products included on that "third round" list were scheduled to increase from 10 percent to 25 percent on January 1, 2019. The effective date of the increase in the duty rate on the products on the "third round" list has, however, been deferred to March 2, 2019, pending the outcome of current trade negotiations between the United States and China. **See** 83 **Fed. Reg**. 65198 (December 19, 2018).

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the imported products in question, as reclassification, if warranted, may resulting in moving the imported products into a HTSUS subheading that is not currently subject to Section 301 duties[4].

(b) **Product Exclusion Process**: In imposing the Section 301 duties on the "first round" and "second round" lists of 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 particular 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]

A further factor that may be particularly relevant is the source of the imported products from China. Thus, if the products are manufactured and supplied to the United States importer by its wholly-owned subsidiary in China, the unreasonable and discriminatory trade practices and policies to which the USTR's Section 301 investigation was directed would not be implicated, as the United States importer would then have been able to make a direct foreign investment in China, and to transfer manufacturing technology to that Chinese entity, without being subject to the foreign investment restrictions or forced technology transfer requirements which the USTR found to be unreasonable and discriminatory, burdening or restricting United States commerce.

The period for submitting product exclusion petitions for products on the "first round" list closed on October 9, 2018; the period for submitting product exclusion petitions for products on the "second round" list closed on December 18, 2018. For products on the "first round" list, approximately 10,000 product exclusion petitions were submitted by importers and other interested parties. On December 21, 2018, the USTR announced the approval of approximately 1,000 of those exclusion petitions, with another 1, 250 exclusion petitions being denied. The USTR's notice indicates that decisions on the additional exclusion petitions with respect to the

[4] Under section 484 of the Tariff Act of 1930, **as amended**, 19 U.S.C. § 1484, importers are subject to a statutory duty of "reasonable care" in the classification of imported merchandise. That duty of "reasonable care" implies classification of the imported merchandise with reference to: (i) the specific terms of the Harmonized Tariff Schedule of the United States; (ii) the General Rules of Interpretation; (iii) the various Section and Chapter Notes to HTSUS; (iv) the Explanatory Notes to the Harmonized Commodity Description and Coding System, published by the World Customs Organization; and (v) various classification rulings issued by U.S. Customs & Border Protection.

[5] **See** 83 **Fed. Reg**. 32181 (July 11, 2018) (product exclusion petitions for the "first round" list); 83 **Fed. Reg**. 47236 (September 18, 2018) (product exclusion petitions for the "second round" list).

"first round" list, as well as the exclusion petitions filed with respect to the "second round" list, will be published periodically, as the USTR works through the backlog of pending petitions. **See** 83 **Fed. Reg.** 67463 (December 28, 2018).

Products for which exclusive petitions have been approved by the USTR are excluded from the Section 301 duties for a period of one year from the effective date of the Section 301 duties (i.e., July 6, 2018 for products included on the "first round" list). It is apparently assumed that that one year exclusion period will provide United States importers and manufacturers that are dependent upon Chinese suppliers for key products, parts and components sufficient time to identify and qualify alternative (non-Chinese) sources of supply.

To date, no notice of procedures for submitting petitions for the exclusion of specific products from the "third round" list has been published by the USTR. It is, however, anticipated that, if and when the Section 301 duties on the products on that "third round" list increase from 10 percent to 25 percent (i.e., on March 2, 2019), the USTR will establish a product exclusion petition procedure comparable to the procedures established for the exclusion of particular products from the "first round" list and the "second round" list. Importers affected by the Section 301 duties on the products included on that "third round" list should carefully consider the submission of product exclusion petitions when the procedure is created, as the December 21, 2018 USTR announcement shows that the standard for excluding particular products from the Section 301 duties may not be insurmountable.

(c) **Alternative Sources of Supply**: The Section 301 duties apply to those products for which China is the country of origin, under United States country of origin marking rules under section 304 of the Tariff Act of 1930, 19 U.S.C. §1304, and implemented by Part 134 of the CBP Regulations, 19 C.F.R. Part 134. 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 is able to 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.[6] 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 three lists of sanctioned Chinese products, they will be subject to the Section 301 duties when imported into the United States[7].

(d) **Third Country Assembly**: 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). Thus, section 134.1(b) of the CBP Regulations, 19 C.F.R. §134.1(b), 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 in order to render such other country the country of origin within the meaning of this part.

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. **See** 19 U.S.C. § 2518 (country of origin standard for purposes of the Trade Agreements Act of 1979); 19 C.F.R. § 134.35. The application and interpretation of that subjective "substantial transformation" standard is informed by a series of country of origin rulings issued by CBP, under the country of origin marking rules of section 304 of the Tariff Act of 1930, and the U.S. Government procurement rules of the Trade Agreements Act of 1979. In determining whether a manufacturing or assembly operation results in such a "substantial transformation" in a particular case, CBP examines the totality of circumstances surrounding the manufacturing or assembly process, including:

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[6] Section 102.1(o) of the CBP Regulations, 19 C.F.R. § 102.1(a) defines "simple assembly" as, "the fitting together of five or fewer parts all of which are foreign (excluding fasteners such as screws, bolts, etc.) by bolting, gluing, soldering, sewing or by other means without more than minor processing." Even assembly processes that involve more than "simple assembly, " as defined in that section 102.1(o) of the CBP Regulations may not meet the "substantial transformation" standard for country of origin purposes.

[7] Incorrectly declaring the country of origin of imported merchandise for the purpose of avoiding Section 301 duties may constitute "customs fraud" under section 592 of the Tariff Act of 1930, as amended, 19 U.S.C. §1592. A fraudulent violation of section 592 is subject to a civil penalty in an amount equal to the total value of the imported merchandise. For purposes of section 592, the CBP Regulations define 'fraud" as follows: "A violation is determined to be fraudulent if a material false statement, omission or act in connection with the transaction was committed (or omitted) knowingly, i.e., was done voluntarily and intentionally, as established by clear and convincing evidence." 19 C.F.R. Part 171, Appendix B, ¶ (C)(3).

- The complexity of the manufacturing or assembly process.
- The number of worker hours required to perform the manufacturing or assembly process, and the level of skill and training required by workers to perform that process.
- Whether complex and sophisticated equipment is used in the manufacturing or assembly process.
- The number of discrete steps required to complete the manufacturing or assembly process.
- The cost of labor and materials used in the manufacturing or assembly process, in relation to the overall cost of labor and materials used in all countries for the complete manufacture and assembly of the products (i.e., the local value added).
- Whether individual components (e.g., of Chinese origin) lose their individual identities through the manufacturing or assembly process, and whether those individual components are functioning devices before being subject to further manufacturing or assembly.
- Whether the imported components (e.g., from China) undergo a change in tariff classification when manufactured or assembled into the finished product.

There has been considerable confusion about the determination of the country of origin of products assembled in Mexico from parts and components of Chinese origin. Sections 102.0 and 134.1(b) of the CBP Regulations indicate that the country of origin of products imported into the United States from another NAFTA country (i.e., Canada or Mexico) is to be determined on the basis of section 102.11 of the CBP Regulations, and the NAFTA rules of origin. In a September 13, 2018 ruling, however, CBP held that, for Section 301 duty purposes, the country of origin of products assembled in Mexico must be determined on the basis of the "substantial transformation" rule described above. **See** HQ H300226 (September 13, 2018). That CBP ruling creates the rather unusual situation in which a product assembled in Mexico from Chinese origin parts and components: (i) may meet the NAFTA rules of origin for marking purposes (i.e., it has undergone the requisite tariff classification shift); but (ii) has not undergone a "substantial transformation" in Mexico. In those circumstances, the product, when imported into the United States, would have to be marked with Mexico as the country of origin, in order to comply with United States country of origin marking requirements, but would have to be declared as a "product of China" for Section 301 duty purposes.

There may also be some confusion as to the circumstances in which the loading of operating system software onto an electronic device is sufficient to constitute a "substantial transformation" of that device. For purposes of developing a Section 301 duty mitigation strategy, the loading of operating system software onto an electronic device may be particularly important where the hardware portion of the device is manufactured and assembled in China, and then the hardware is shipped to a third country where the operating system software is loaded onto the device. In those circumstances, the operating system software may be essential to the functioning of the device, and may constitute a very large portion (perhaps most) of the total value of the finished device.

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In its decision in *Data General Corp. v. United States*, 4 CIT 182 (1982), the Court of International Trade held that the **programming** of an electronic device (in that case a programmable read only memory chip or PROM) constituted a substantial transformation of that device for country of origin purposes. In reliance upon that **Data General** decision, it may have been assumed that the downloading of operating system software onto an electronic device was sufficient to constitute a "substantial transformation" of the device. That approach, however, was rejected by CBP in HQ H241177 (December 10, 2013). In that ruling, CBP confirmed that the "programming" of an electronic device may constitute a "substantial transformation" of that device, but held that the downloading of software to a device does not equate with "programming" that device. To the contrary, for substantial transformation purposes, programming of an electronic device in a particular country will be deemed to occur only if (i) the software is developed and written in that country; and (ii) the software is then downloaded to the electronic device in that same country.[8]

It should be emphasized that simple assembly or minor processing, as those concepts are defined in section 102.1 of the CBP Regulations, 19 C.F.R. §102.1, will **not** be sufficient to constitute a "substantial transformation" for United States country of origin purposes. For that reason, United States importers that procure products from offshore suppliers or contract manufacturers should view with a good deal of skepticism "facile" solutions that may be offered by those suppliers or contractors to change the country of origin of their products from China to a third country, in order to avoid the impact of the Section 301 duties. Any "substantial transformation" analysis to determine the country of origin of a particular product must be performed on a case-by-case, product-by-product basis with reference to all of the relevant parts and circumstances, especially a detailed consideration of the third country manufacturing or assembly processes.

(e) **Disaggregation and Final Assembly in the United States**: The Section 301 duties apply to "products of China", when imported into the United States. To the extent that a United States importer has been importing complete systems from a Chinese vendor, where the full value of those complete systems is now subject to Section 301 duties, the United States importer may consider, as a Section 301 duty mitigation strategy, the "disaggregation" of those complete systems into their constituent components or subassemblies, for purposes of importation into the United States. The potential benefits of such a "disaggregation" approach as a Section 301 duty mitigation strategy include the following:

- If all, or substantially all, of the components or subassemblies are of Chinese origin, the Section 301 duties will only apply to the customs value of those components or subassemblies. If the components or subassemblies are configured and assembled into the complete systems in the United States, the value of the configuration and assembly work done in the United States will not enter into the dutiable value subject to the Section 301 duties.

[8] Depending on the relevant parts and circumstances, the downloading of operating system software in a particular country, together with significant hardware assembly operations performed in that country, may be sufficient to constitute a "substantial transformation" of the final product from the parts and components from which it is assembled. See, e.g., HQ H282390 (January 30, 2018).

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- As a variation on the foregoing theme, if a key element (and major portion of the value) of the complete systems is the operating system software, then the disaggregation, in the form of loading that operating system software in the United States, after the hardware components have been imported from China, will mean that only the value of the hardware components will be subject to the Section 301 duties (to the extent applicable to that class of merchandise). By contrast, if that operating system software is loaded onto the complete system in China, then the full value of the complete system (both the hardware value and the software value) may be subject to the Section 301 duties.

- If various constituent components or subassemblies of the complete systems originate in one or more countries other than China, the disaggregation approach, with the direct importation of those third country components or subassemblies into the United States, will have the effect of excluding the value of those components or subassemblies from the Section 301 duties. By contrast, if those third country components or subassemblies are imported into China, and then incorporated into the complete systems, in a manufacturing or assembly process that constitutes a "substantial transformation", then the country of origin of the complete systems will be China, potentially subject to Section 301 duties on the full value of the complete systems when imported into the United States.

(f) **Valuation on the Basis of the First Sale for Export to the United States:** Under section 402(b) of the Tariff Act of 1930, as amended, 19 U.S.C. § 1401a(b), the primary method for determining the value for Customs purposes of imported merchandise is the "transaction value". The transaction value of imported merchandise is the actual price paid or payable for that merchandise 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 that merchandise.

In a multi-tier procurement structure, however, it may be possible to reduce the customs value of merchandise imported from China, and therefore the amount that will be subject to Section 301 duties, on the basis of the doctrine of "first sale for export". The opportunity to mitigate the effect of the Section 301 duties on imported Chinese merchandise may therefore arise in circumstances in which a Chinese manufacturer sells the merchandise to an intermediary in a third country, and that intermediary resells the merchandise 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 merchandise is imported into the United States[9] (i.e., valuation on the basis of the "first sale").

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 merchandise for customs purposes on the basis of the price of sale of that merchandise from the foreign manufacturer to a third country intermediary:

[9] *See, e.g., Nisshio Iwai American Corporation v. United States*, 982 F.2d 505 (Fed. Cir. 1992).

- There must be a bona fide sale of the merchandise 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 merchandise at "arm's length".[10]
- At the time of the sales transaction between the manufacturer and the intermediary, the merchandise must be clearly destined (irrevocably committed) to exportation to the United States.

If a United States company that imports Chinese origin products that are subject to Section 301 duties in a multi-tier procurement arrangement can demonstrate that the procurement arrangements satisfy the foregoing conditions, that United States company may effectively reduce the burden of the Section 301 duties by declaring the value of the imported Chinese products on the basis of the (lower) price paid or payable by the intermediary in the first sale.

(g) **Customs Duty Preference under Subheading 9802.00.80, HTSUS**: Subheading 9802.00.80, HTSUS establishes a special duty preference for certain imported merchandise 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, 19 C.F.R. §§10.13 et seq. By a notice dated July 3, 2018, **Cargo Systems Managing Service #18-000419 -- Update: Section 301 Trade Remedies to be Assessed on Certain Products from China 7/6/18**, CBP stated that the Section 301 duties shall not apply to products for which entry is properly claimed under a heading or subheading in Chapter 98 (i.e., including 9802.00.80, HTSUS). A CBP FAQ on the application of the Section 301 duties amplifies that **Cargo Systems Managing Service** notice, and explains that: "For heading 9802.00.80, the additional duties apply to the value of the article less the cost or value of such products of the United States, as described in heading 9802.00.80."

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 merchandise 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.

[10] Where the manufacturer and the intermediary are unrelated parties, CBP will consider that the sale was conducted at arm's length. If those two parties are related, however, then it will be necessary to demonstrate to CBP that the relationship between the parties did not affect the price of the merchandise, as provided in section 402(b)(2)(B) of the Tariff Act, 19 U.S.C. § 1401a(b)(2)(B).

- 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.

The duty preference is, therefore, only available when the United States origin fabricated components are "assembled" abroad. The concept of such "assembly" is defined in section 10.16 of the CBP Regulations, 19 C.F.R. §10.16, 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", as provided in section 10.16(b) of the CBP Regulations.[11]

If products assembled in China from United States origin fabricated components meet the foregoing conditions, and therefore qualify for the duty preference of subheading 9802.00.80, HTSUS, 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.

The use of subheading 9802.00.80, HTSUS may be of particular value, as a Section 301 duty mitigation strategy, for semiconductor companies that "fab" the wafers for their products in the United States, and then have those wafers assembled into finished integrated circuits in China. There is specific authority, in the form of examples in the CBP Regulations, and in various rulings issued by CBP, for the position that the assembly of die and wafers into finished integrated circuits may qualify as an "assembly" process under section 10.16 of the CBP Regulations for purposes of the duty preference of subheading 9802.00.80, HTSUS. **See** 19 C.F.R. §10.14, example 2, 19 C.F.R. § 10.16(d), example; HQ W563527 (September 29, 2006); NY C89860 (July 31, 1998); NY C86075 (April 7, 1998); HQ 559071 (August 25, 1995).

[11] Section 10.16(b) of the CBP Regulations, 19 C.F.R. § 10.16(b), 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 prestamped integrated circuit lead frames exported in multiple unit strips;
(7) final calibration, testing, marking, sorting, pressing, and folding assembled articles.

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(h) **Duty Drawback on Products Imported from China and Subsequently Exported**: Section 313 of the Tariff Act of 1930, as amended, 19 U.S.C. §1313, and Part 191 of the CBP Regulations, 19 C.F.R. Part 191, authorize the drawback of duties paid on importation of merchandise into the United States when that merchandise 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 merchandise or same condition drawback). The drawback statute allows the recovery of 99 percent of the duties originally paid on the imported merchandise, when that merchandise is subsequently exported, subject to the various conditions and requirements set forth in Part 191 of the CBP Regulations.[12]

The CBP **Cargo Systems Managing Service** #18-000409 notice on the Section 301 duties specifically provides that those Section 301 duties are eligible for duty drawback. For those United States companies that import products from China that are subject to the Section 301 duties for use in the manufacture of finished goods in the United States at least some of which may be exported[13], or for subsequent global distribution from the United States, a duty drawback plan may, therefore, be a key Section 301 duty mitigation strategy. For those products imported from China and subject to Section 301 duties, and then subsequently exported from the United States, the United States company with an approved drawback plan will be able to recover 99 percent of the Section 301 duties paid.

As a variation on this theme of Section 301 duty mitigation with respect to products imported into the United States and then subsequently exported, a company that uses the United States as a global distribution hub may also wish to consider operating that global distribution hub in a Foreign Trade Zone ("FTZ"). Products imported from China into an FTZ, and then subsequently exported from the FTZ to another country, will not incur the Section 301 duties.[14] It should be noted, however, that Chinese origin products subject to Section 301 duties, when admitted to an FTZ, will be admitted with "privileged foreign status" as defined in section 146.41 of the CBP Regulations, and will be subject to Section 301 duties on the full value of those Chinese origin products if transferred from the FTZ to the Customs Territory of the United States. **See** 19 C.F.R. §146.65(a).

[12] Products manufactured in the United States which incorporate imported parts and components must be exported within 5 years of the date of importation of those parts and components to be eligible for duty drawbacks under the manufacturing drawback statute and regulations, 19 U.S.C. § 1313(i); 19 C.F.R. § 191.27(a). Products imported into United States and subsequently exported in the same condition must be exported within 3 years of the date if importation in order to be eligible for duty drawback under the unused merchandise drawback statute and regulations, 19. U.S.C. § 1313(j)(1)(A); 19 C.F.R. § 191.31(b).

[13] A company that seeks to claim duty drawback on exportation of products manufactured in the United States, using imported components that are subject to duties, including Section 301 duties, must operate under a manufacturing drawback ruling from CBP, either pursuant to a letter of notification to operate under one of the general manufacturing drawback rulings published in the Appendix to Part 191 of the CBP Regulations, or under a specific manufacturing drawback ruling obtained from CBP under section 191.8 of the CBP Regulations, 19 C.F.R. § 191.8.

[14] 19 U.S.C. § 81c(a) provides that foreign merchandise may, without being subject to the customs laws of the United States, be brought into an FTZ, and may be stored, repacked, tested, processed, assembled, distributed, sorted, graded, manipulated and/or manufactured within the FTZ, and exported therefrom without issuing customs duties [including Section 301 duties].

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4. Conclusion

The imposition of Section 301 duties on a huge volume of merchandise imported from China presents enormous financial and compliance challenges for United States companies that rely upon vendors and contractors in China as key elements of their supply chains. The challenges may be particularly great for those United States companies whose imports from China have heretofore been duty-free (i.e., zero rated), such as electronics companies that rely upon contractors manufacturing their products in China (e.g., where the products have been duty-free under the Information Technology Agreements).

It may, however, be possible to 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 a company's manufacturing and procurement operations.

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