RULES OF ORIGIN POST BREXIT

What are Rules of Origin?

Put simply, rules of origin are how customs authorities classify where an export has come from in international trade.

How will Rules of Origin affect UK-EU trade post-Brexit?

There are two main ways:

- **Preferential Rules of Origin:** If the UK and the EU agree under a free trade agreement (FTA) to remove tariffs for each other's goods, this grants a preference not provided to others. UK goods seeking to enter the EU under this preference will have to prove that they are from the UK under particular rules agreed in an FTA. This prevents a country without a trade deal from accessing the EU market through the UK and vice versa.

- **Non-Preferential Rules of Origin:** Outside a Customs Union, all UK exporters will still have to declare the origin of their goods when trading with the EU. This is used by importing countries to protect their producers and for other monitoring purposes. For instance, if the UK or EU felt that imports are unfairly damaging its own producers, it could apply a temporary tariff to the import. In this case, the EU or the UK would need to differentiate the origin of the import it wished to apply duty to so it did not apply tariffs to another country.

- Both the UK and the EU have published mandates for a trade deal which would mean both kinds of rules of origin will apply.

Both types of 'rules of origin' can significantly affect the free movement of goods.

The 2013 Trade and Investment Balance of Competence Review states that "British firms would be exposed to a combination of administrative and compliance costs linked to rules of origin, ranging (based on existing estimates) from 4 percent to perhaps 15 percent of the cost of goods sold." The complexity of supply chains can mean that proof of origin can be difficult for traders to supply and hard for authorities to assess.

For exporters, the costs of providing proof for preferential origin can outweigh the benefits. Steve Elliott, Chief Executive Officer of the Chemical Industries Association, stated in a House of Lords report that due to several stages of synthesis involved, the cost of providing technical proof "would clearly outweigh the benefit of duty-free sales".

How is the origin of goods determined?

The first need is to determine what good is being traded. The World Customs Organisation (WCO) has a list classifying every product traded under tariff headings. Each product has a unique code which is grouped into broader categories.

Once the good is classified, the next step is to establish its "economic nationality" as opposed to simply the country it came from. This involves determining the good's value and where the contributions were made in *adding value* to the final product (see "sufficient value-added" below).

If all materials were obtained and processed in one state, it would be "wholly obtained" in that country. That would apply, for example, to agricultural produce and natural resources.

What about for more complex manufactured goods?

A car has multiple components: bumpers, brakes, clutches, computer software, leather seats and rubber tyres, etc. These can be made in different countries and shipped as needed to be assembled into the final product. With multiple components adding value, it can be very difficult to determine origin for some products. In this case, the final product is determined by the location of the "last substantial transformation".

For preferential origin, substantial transformation is defined through one or a combination of three main criteria:

- **Change of tariff classification:** When the work undertaken within a country results in a change of classification. For example, the unique code for car parts, 8708, is different to the code for a finished car, 8703. If a country assembles car parts into a finished car, it would qualify as a change of tariff classification.
- **Sufficient value-added:** The originating state must contribute a minimum percentage of the value of a product. Each component will add a certain amount of value, calculated as the percentage of the ex-works price of the final good (i.e. the total price of the inputs to the good exempting transportation and insurance costs). Typically, around 50%+ of value has to be added to claim origin.
- **Specific processing:** Finished products can qualify when particular specific working or processing activities are carried out. For example, a rule may require clothing products to be manufactured from yarn.

The precise rules are very detailed and can change for each product depending on what is agreed in an FTA. Similar principles apply to determining non-preferential origin, but there is a global agreement on what the rules are covering most goods.

Transaction Value/Net Cost Formulae

For Origin purposes, the Transaction Value Formula that is used for all Global Free Trade Agreements can be expressed as follows, together with the 60/40 or other percentage rules;

$$\frac{TV - VNM}{TV} \times 100\%$$

Where:

TV = Transaction Value (i.e. Total EXW Factory Gate Value)
VNM = Value of Non-Originating Materials

The other Formula is the net cost method, where the Net Cost equals the cost of producing the goods, but without the inclusion of profit. This is usually set for most Free Trade Agreements at 50% of the total transaction value of the goods, and is expressed as follows:

$$\frac{NC - VNM}{NC} \times 100\%$$

Where:

NC = Net Cost (i.e. Total Cost of Materials + Labour/Processing Costs + Overheads)
VNM = Value of Non-Originating Materials

Based on the Net Cost method, the Customs/Revenue Authority generally allows the profit margin to be adjusted to achieve origin status.

After Brexit, will UK goods meet the origin threshold to qualify for preferences?

Typically, for preferential origin, around 50%+ of value has to be added to claim origin. Post-Brexit, what was once European value-added will have to be separated into UK and EU value-added. That will make it harder to reach the threshold to export to the EU without tariffs.

According to Mike Hawes, Chief Executive of the Society of Motor Manufacturers and Traders, one example of the challenges this poses in evidence to the Business, Energy and Industrial Strategy Select Committee. He noted that the average car made in the UK purchases 44% of its components from UK suppliers. But the proportion of this actually made in the UK "is somewhere between 20% and 25%", which is a long way from the 55–60% threshold needed to qualify for any FTA. Hawes has pointed out that to move from where we currently are — let us say 20% to 25% originating content — to 60% will take many years. There is not necessarily the capability here in the UK.

How could UK goods seeking to enter the EU meet the threshold to prove origin?

One of the ways this problem is avoided by other countries is to allow "cumulation" of value added. There are different kinds of cumulation, but the main purpose is to allow the value of components contributed by different countries to be combined to meet the threshold when a product is re-exported. So to maintain existing supply chains, the UK would want to be able to count EU components toward UK content so that it could reach the threshold to re-export to the EU.

Originating Status

Products have originating status if they are either "wholly obtained" or sufficiently worked or processed. This applies to all preferential origin arrangements.

Wholly obtained

Wholly obtained applies mainly to natural products from the beneficiary country and to goods made entirely from them. This means that a product cannot contain imported non-originating elements.

Sufficiently worked or processed

Non-originating materials or components must be sufficiently worked in order to obtain origin. Sufficiently worked means sufficiently worked according to the specifications of the list rules.

CUMULATION

Cumulation is the term used to describe a system that allows originating products of country A to be further processed or added to products originating in country B, just as if they had originated in country B. The resulting product would have the origin of country B. It can only be applied between countries operating with identical origin rules.

An important point to remember is that in the case of cumulation the working or processing carried out in each partner country on originating products does not have to be 'sufficient working or processing' as set out in the list rules.

There are four types of Cumulation: Bilateral, Diagonal, Regional and Full.

Bilateral Cumulation

Bilateral cumulation operates between two countries where a free trade agreement or autonomous arrangement contains a provision allowing them to cumulate origin. This is the basic type of cumulation and is common to all origin arrangements. Only originating products or materials can benefit from it. This facility exists between the EU and the UK in terms of the UK-EU trade and Co-operation Agreement (TCA).

Diagonal Cumulation

Diagonal cumulation operates between more than two countries provided they have Free Trade Agreements containing identical origin rules and provision for cumulation between them. As with bilateral cumulation, only originating products or materials can benefit from diagonal cumulation.

Although more than two countries can be involved in the manufacture of a product it will have the origin of the country where the last working or processing operation took place, provided that it was more than a minimal operation. Diagonal cumulation operates between the European Union and the countries of the so-called "pan-Euro-Mediterranean cumulation zone".

Regional Cumulation

Regional cumulation is a form of diagonal cumulation, which only exists under the Generalised System of Preferences (GSP) and operates between members of a regional group of beneficiary countries (e.g. ASEAN).

Full Cumulation

Full cumulation allows the parties to an agreement to carry out working or processing on non-originating products in the area formed by them. Full cumulation means that all operations carried out in the participating countries are taken into account. While other forms of cumulation require that the goods be originating before being exported from one party to another for further working or processing, this is not the case with full cumulation. Full cumulation simply demands that all the working or processing in the list rules must be carried out on non-originating materials in order for the final product to obtain origin.

Full cumulation is in operation between the European Union and e.g. the countries of the EEA, Maghreb , OCT or ACP.

Minimal operations

Minimal operations are operations that when carried out either individually or in combination are regarded as being of such minor importance that they never confer originating status. All **preferential** origin rules contain an article, which defines the working or processing which is to be regarded as insufficient to confer origin. (e.g. Article 7 of Protocol No 4 of the Europe (Association) Agreement with Bulgaria).

Working or processing carried out on a product that satisfies the list rule shall not result in the product obtaining origin if that working or processing is mentioned as a minimal operation set out in the relevant article.

However, when allocating origin **within a cumulation system**, any working or processing carried out must exceed the above-mentioned minimal operations but does not necessarily need to satisfy the relevant list rule of the arrangement.

If no operations are carried out on EU goods entering the UK and then re-exported to the UK, these goods lose their preferential status and will be subject to import duties on re-entry into the EU. For preferential status to apply, the goods must eb imported into a UK Customs Warehouse, meaning that they do not enter UK Free Circulation and therefore can retain their original EU origin status, thus meaning that they can be re-imported into the EU on a duty-free basis.

General tolerance rule

The general tolerance rule permits manufacturers to use non-originating materials up to a specific percentage value of the ex-works price. However, should the specific working or processing rule already allow the use of non-originating materials the tolerance cannot be used to exceed the percentage amount specified in the list rule. The maximum will always be that allowed by the specific rule. The percentage of the tolerance allowed varies from one preferential regime to another.

The general tolerance rule does not apply to textile goods of Chapters 50 to 63 (inclusive). Specific tolerance rules for textiles are included in the introductory notes to the list rules.

"No drawback" rule

The term drawback means refunding duties paid on imported goods and the "no drawback" provision where duty refunds are not allowed. This rule ensures that duties applicable to imports of third country materials are paid. The objective of this rule is to prevent unfair competition in national markets.

However, some agreements allow for **partial drawback** for a limited period. The reason for this derogation is because the customs duties applicable to non-originating materials in some countries are considerable higher than those applicable in the Community and by allowing a refund to a certain level the imbalance, which could be seen as favouring Community producers, is reduced.

Principle of territoriality

The principle of territoriality means that the working or processing must be carried out in the territories of the parties.

Due to modern manufacturing processes it is not always possible to fulfil this requirement. It may be necessary to do some processing in a country not party to the preferential arrangement. Some arrangements allow such external working or processing provided it conforms to certain specified conditions.
Failure to comply with the specified conditions will result in the returning product being treated as non-originating.

In most cases the derogation from the principle of territoriality does not apply to textile products of Chapters 50 to 63 (inclusive) and nor can a product benefit from both this derogation and the general tolerance rule at the same time.

When determining the origin of the final product, working or processing performed outside the territory of the contracting parties is not to be taken into account. However, when calculating the value added, the total added value of the working or processing done outside the territory of the

contracting parties must be taken together with the value of the non-originating materials incorporated in the territory of the other contracting party.

The combined values (the value added outside the territory and the value of the non-originating materials) should not exceed the percentages stated in the relevant list rule.

Direct transport rule

Preferential arrangements contain rules concerning the transportation of preferential goods from one party's territory to another. The purpose of direct transport is to ensure that the goods arriving in the country of import are the same as those which left the country of export. However, if for any reason the goods pass through or stop-over in, the territory of a third country provided that they stay under Customs supervision, i.e. goods in Customs-controlled transit, the conditions of direct transport are considered to have been fulfilled.

Proof of compliance with the direct transport rule may be given by a single transport document covering the passage of the goods through the country of transit or, for example, a "non-manipulation certificate" issued by the authorities of that country.

Proof of Origin

When goods are claimed to have a particular preferential origin, the customs authorities of the importing country must be satisfied that the claim is correct and thus a proof of that origin is required. The different preferential arrangements require specific proofs of origin relevant to specific arrangements. For example, the preferential arrangements the Community has with certain countries require a movement certificate EUR.1 or EUR-MED whereas under GSP a certificate of origin Form A is required. Traders are advised to check which particular proof of origin is required to substantiate their claims to preferential origin. Declaration on certain commercial documents (an invoice, a delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified - the so-called "invoice declaration") can replace the specific proof of origin. This is subject to prior authorisation by the Customs authorities granted to Approved Exporters**.** Additionally, most arrangements allow the use of "invoice declarations" made out by the exporter for any consignment under a certain value.

A supplier’s declaration can be used by a supplier to declare the originating status of the goods he provides to his customer who may need this information to certify the preferential origin of the goods he exports. Guidance on the Application in the EU of the provisions concerning the Supplier’s Declaration have been agreed by the Customs Expert Group – Origin Section.

In limited circumstances proofs of origin can be issued retrospectively and in cases of loss or destruction the exporter can apply for a duplicate certificate.

When provided for in the legislation, it is possible to replace the original proof of origin by one or more movement certificates. Guidelines on application in the EU of the provisions concerning replacement Movement Certificates have been agreed by the Customs Code Committee in this regard.

It is pointed out that both certificate of origin Form A and movement certificate EUR.1 or EUR-MED must comply with a number of specific technical requirements which are laid down in each arrangement. One of these requirements is that they must have a printed green guilloche pattern background. There is no single model, but an enlarged illustration of a type of "green guilloche-pattern background" is available.

Guidelines of application in the EU of the provisions concerning printing technical requirements of

movement certificates EUR.1, EUR-MED, A.TR and Certificates of Origin Form A (GSP) have been agreed by the Customs Code Committee in this regard. For information, the Guidelines were written in English and the original version will prevail. In case of divergence between different language versions, reference should be made to the initial version in English.

Period of validity of proofs of Origin

Documentary proofs of origin have a limited life span according to each arrangement. The period starts running as from the day the proof of origin is issued. However, there can be exceptional circumstances in which presentation of the proof of origin may be accepted after that time period. The Customs Code Committee has also agreed guidelines concerning the belated presentation of proofs for goods placed under a suspensive procedure. Finally, exporters are obliged to retain copies of all proofs of origin and documents related to them for a period of three years from the date of issue.

Exemptions from the requirement to present proof of origin

There are exemptions from the requirement to present a proof of origin, always provided that the goods are not imported by way of trade. Small packages sent from one private person to another up to a specified maximum value are permitted entry without proof of origin. Traveller's personal luggage also benefits from a similar concession up to a specified maximum value.

Administrative co-operation

Administrative cooperation is common to all origin arrangements. It is the framework for cooperation between the competent authorities of partner countries enabling them to check that the rules are being properly applied. On the one hand, partners must provide each other with impressions of the stamps they use to authenticate certificates of origin. On the other hand, it allows customs administrations to make post-import checks on the authenticity and the accuracy of proofs of origin.

Operators should note that if it transpires that the goods are or were not actually entitled to the preference, preferential treatment would be refused and any duty not paid may be recovered. It is therefore in importers' own interests to do what they can before import to check all the information concerning the proof of origin and the goods covered by it to find out if they are entitled to preference.

Notices to Importers - reasonable doubts as to the origin of goods

In accordance with Point 3(1) of the Communication from the Commission No. 2012/C 332/01, the Commission publishes notices to importers in the Official Journal (OJ) of the European Union. This is in order to inform European Union economic operators (importers) of reasonable doubts as to the origin of goods covered by preferential tariff arrangements.

As mentioned in the Communication, the list of notices that is attached to the Communication is to be updated but only in its website version. This means that the list annexed to the Communication published in the OJ may become obsolete. For this reason, please refer to the list published on this website in order to check notices that are valid as of the date of publication of the Communication.

If a notice to importers has been published by the Commission, economic operators cannot plead good faith with regard to goods falling with the scope of this notice. This is established in the last paragraph of Article 220(2) (b) of the Community Customs Code. Detailed information concerning customs debt, including the application of Article 220(2) (b) may be found on the dedicated web page.

Approved exporter

An approved exporter is an exporter who has met certain conditions imposed by the customs authorities and who is allowed to make out invoice declarations. Just as the customs authorities can grant that status, they can also withdraw it if the exporter misuses or abuses the authorisation. The procedures attached to granting "approved exporter" status depend on national provisions.

Under certain conditions, a **'single authorisation'** may be granted to an approved exporter, who is established in one Member State, where he keeps his records containing the evidence of origin, but whose products are exported from other Member States (see Article 8 of Council Regulation (EC) No 1207/2001 of 11 June 2001).

LIST RULES

Each arrangement has an annex containing the list of working or processing required to be carried out on non-originating materials in order that the product manufactured can obtain originating status ("The list rules") and is preceded by an annex containing introductory notes to the list rules.

This list of working or processing is based on the Harmonised System (HS) and contains for each position the appropriate condition(s). A position can be all products of a chapter, a heading or a group of headings or just a specific selection of these products (so-called "ex" position). In the case of an ex-position the rule applies only to the product as described in column 2.

Therefore, to use the list of working or processing it is necessary to first identify the tariff heading of the finished product. Secondly it must be checked whether the finished product has complied with the qualifying process listed in column 3 or 4 for the finished product of that heading. If this is not the case, a product may still be originating if the value of the non-originating materials does not exceed the general tolerance rule, here applicable.

There are several types of rules but the most common (see table of examples) are:

- that only wholly obtained materials can be used (a);
- that non-originating materials from certain positions can be used in or are excluded from the working or processing (b);
- that a specific working or processing operation must be carried out (c);
- that a certain percentage of value is added or cannot be exceeded in the production process (d);
- a combination of different rules (e)
- that a choice between different rules is given (f)

Where, for the entry in the first two columns, a rule is specified in both columns 3 and 4, the exporter may opt to apply either the rule set out in column 3 or the one set out in column 4 (g). If no rule is given in column 4, the rule set out in column 3 must be applied.

For example:

Type of Rule	**(1) HS-heading**	**(2) Description of product**	**(3) Working or processing, carried out on non-originating materials, which confers originating status**	**(4) Working or processing, carried out on non-originating materials, which confers originating status**
a	Chapter 2	Meat and edible meat offal	Manufacture in which all the materials of Chapters 1 and 2 used are wholly	...

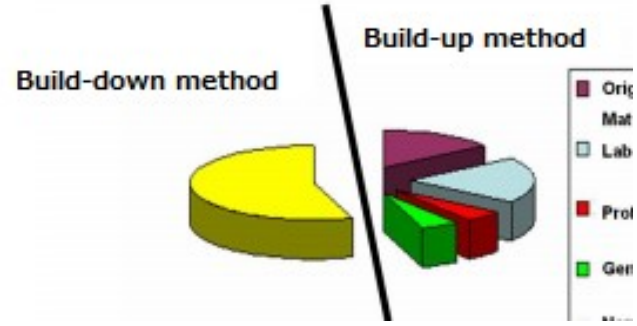
			obtained	
b	ex 2104	Soups and broths and preparations thereof	Manufacture from materials of any heading, except prepared or preserved vegetables of headings 2002 to 2005	...
c	ex 4407	Wood sawn or chipped lengthwise, sliced or peeled, of a thickness exceeding 6 mm, planed, sanded or end-jointed	Planing, sanding or end-jointing	...
d	Chapter 92	Musical instruments; parts and accessories of such articles	Manufacture in which the value of all the materials used does not exceed 40 % of the ex-works price of the product	...
e	2202	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavoured, and other non-alcoholic beverages, not including fruit or vegetable juices of heading 2009	Manufacture: - from materials of any heading, except that of the product, - in which the value of all the materials of Chapter 17 used does not exceed 30 % of the ex-works price of the product, and - in which all the fruit juice used (except that of pineapple, lime or grapefruit) is originating	...
f	7013	Glassware of a kind used for table, kitchen, toilet, office, indoor decoration or similar purposes (other than that of heading 7010 or 7018)	Manufacture from materials of any heading, except that of the product or Cutting of glassware, provided that the total value of the uncut glassware used does not exceed 50 % of the ex-works price of the product or Hand decoration (except silk-screen printing) of hand-blown glassware, provided that the total value of the hand-blown glassware used does not exceed 50 % of the ex-works price of the product	...
g	8411	Turbo-jets, turbo-propellers and other gas turbines	Manufacture: - from materials of any heading, except that of the product, and - in which the value of all the materials used does not exceed 40% of the ex-works price of the product	Manufacture in which the value of all the materials used does not exceed 25 % of the ex-works price of the product

However, there are other rules or combinations of conditions possible and it is therefore necessary always to check the annex to see which rule is applicable.

For an overview of the arrangements with their respective lists, it is recommended to consult first the appropriate legal framework as mentioned in each sector or enter through the list of all arrangements.

Comparison of Build-down and Build-up method under the FTA Rules of Origin

Main differences between “Build-Down Method” and “Build-Up Method”



	Build-down method	Build-up method
Overview	The use of foreign input materials in the manufacturing or processing operations carried out in a contracting party or a specified area is limited to a maximum amount.	The domestic content, e.g. the value of originating materials and the manufacturing or processing operations carried out in a contracting party or in a specified area, must be equal to or exceed a given percentage of the value of the final product.
Calculation method	This method requires a comparison between the value of the foreign input or the materials with undetermined origin and the value of the final product.	This method requires a comparison between the value added in a contracting party or in a specified area, and the value of the final product.

Examples of Calculation Method	Indirect method Transaction value method Net cost method Focused value method Maximum Allowance for NonOriginating Material	Direct method Minimum Requirement of Domestic Content

Calculation Method of Build Down

$$RVC = \frac{\text{FOB Value} - \text{Value of non} - \text{originating mater}}{\text{FOB Value}}$$

Calculation Method of Build Up

$$RVC = \frac{\text{Value of locally produced materials} + \text{direct labour \& overheads} +}{\text{FOB Value}}$$

Features of the Ad-Valorem Rule / Value-Added Criterion

The exact methods for calculating the input materials and the final product are stipulated in the applicable agreement.

A direct comparison between the percentages used in the different methodologies cannot be made because of the different calculation bases.

The higher the allowed percentage for use of non-originating material, the more liberal the origin rule.

The higher the minimum requirement for the domestic content, the more stringent the origin rule.

The ad-valorem calculation may also vary according to the price basis used for the final product, i.e. the price of the final product at the moment when it leaves the factory (ex-works price), or the price of the final product at the time of exportation or importation (FOB or CIF price).

1. Suitable for goods which have been further refined or processed without a change of tariff classification;

2. Value-added criterion is relatively easy to understand and to apply in practice; value-added rules allow simple and flexible adjustments for different stages of development of developing countries;

3. Economic operators are familiar with the cost components of their inputs as the values are known for commercial and Customs purposes;

4. The administration of value-added rules is complex for small and medium sized companies and may demand additional book-keeping and sophisticated accounting systems;

5. Requires disclosure of sensitive commercial information by suppliers;

6. Relatively high administrative burden due to the necessity to calculate the various cost components;

7. Susceptible to the impact of fluctuating exchange rates. A weakening of the exchange rate raises the value of the foreign inputs in relation to the total cost/ex-works price of a given product. An increase of the exchange rate of a foreign currency (imported goods are often invoiced in foreign currencies) will cause an increase of the value of all imported components
   priced in a foreign currency. This will render a given ad-valorem rule more restrictive;

8. Susceptible to commodity value fluctuations.

(**Source: WCO ORIGIN COMPENDIUM**)