Rules of Origin

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Suzanne M. Richer joined Amber Road in 2015 to lead the development of a Trade Advisory Practice. She is a licensed customs broker and Certified Classification Specialist™ (CCLS™). Ms. Richer has extensive experience in advising corporations on Focused Assessments, C-TPAT cargo security applications and validations, and the Importer Self-Assessment (ISA) program, as well as classification projects. She has authored twelve books on international trade topics.

Prior to joining Amber Road, Ms. Richer established Customs & Trade Solutions, Inc. During her twenty years as a trade advisor, she led C-TPAT validations all over the world, and guided many firms into the coveted Tier 3 status of the program.
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Millions of Dollars Unclaimed due To Origin

Does this describe You?
What Are Rules of Origin?

• Criteria needed to determine the national source of a product.

• No specific rules in GATT – each party determines its own origin rules.
Rules or Origin / FTAs

• Preferential Treatment

• Still Requires Documented and Verifiable Proof of Eligibility
Substantial Transformation

A “Substantial Transformation” occurs when an imported article emerges from processing as a New and different article, with a -

• New name,
• Character and use.

- Imported juice concentrate blended with:
  - Water
  - Orange essences
  - Orange oil
  - U.S. juice concentrate
- No substantial transformation - imported juice concentrate is the “very essence” of the finished products
Methods for Determining Substantial Transformation

• Process and manufacturing analysis (subjective and possibly complex);

• Tariff shift rule (classification change);

• Ad valorem percentage (value added).
Generalized System of Preferences (GSP)

- Global trade preference
- Non-reciprocal program
- Largest (122 beneficiary countries) and oldest (1974) U.S. trade preference program;
- Congressional authorization next expires December 31, 2017.
GSP Qualifying Criteria

• Must be produced in BDC:
  – Wholly the growth, product, or manufacture of the beneficiary developing country; or
  – Substantially transformed in the beneficiary developing country into a new and different article of commerce.
  – Imported Directly
GSP Value-Added Criteria

• Direct cost of processing:
  – Direct costs of processing operations performed in the beneficiary developing country or member countries is not less than **35 percent** of the appraised value of the article at the time it is entered.
Claim Documents

• Must be readily available from importer and/or foreign exporter:
  – GSP Declaration (see 19 CFR 10.173)
  – Bill of Materials (BOM)
  – Invoices
  – Purchase Orders
  – Production records kept in the ordinary course of business

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Double Substantial Transformation

• Materials imported into a BDC may be included in the value-content requirement only when they undergo a **double substantial transformation**.
  – The value may be counted only if the imported material is first substantially transformed into a new and different article of commerce
  – That Article is then used in the BDC to produce the final article imported into the U.S.
Just how simple and objective have origin determinations become?
U.S. General Rules of Origin
(Not Apparel) 19 CFR 102.11

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.
General

- In the United States, the NAFTA is implemented in
  - General Note 12, Harmonized Tariff Schedule of the United States (HTSUS)
Typical Errors

• I bought it in the USA therefore it must be NAFTA qualifying
• Is there really money savings to qualify something for NAFTA?
• The NAFTA Certificate can be done by anyone; after all, isn’t everything already Duty Free already?
NAFTA – Preference Criterion

- Criterion A
- Criterion B
- Criterion C
- Criterion D
- Criterion E
- Criterion F

(19 CFR, Appendix to Part 181 – Rules of Origin Regulations and General Note 12(b), HTSUS)
NAFTA - Preference Criterion

• The preference criterion do not have to be applied sequentially. A producer or exporter is allowed to try to satisfy any one of the criterion - there is no hierarchy

• The NAFTA “Preference Criterion Codes” are to be indicated in the NAFTA Certificate of Origin Customs Form 434
**NORTH AMERICAN FREE TRADE AGREEMENT**  
**CERTIFICATE OF ORIGIN**

**1. EXPORTER NAME AND ADDRESS**

**2. BLANKET PERIOD (DD/MM/YY)**

**TAX IDENTIFICATION NUMBER:**

FROM

TO

**3. PRODUCER NAME AND ADDRESS**

**4. IMPORTER NAME AND ADDRESS**

**TAX IDENTIFICATION NUMBER:**

**5. DESCRIPTION OF GOOD(S)**

**6. HS TARIFF CLASSIFICATION NUMBER**

**7. PREFERENCE CRITERION**

**8. PRODUCER**

**9. NET COST**

**10. COUNTRY OF ORIGIN**

---

**Signature:**

**ACCURATE AND I ASSUME THE RESPONSIBILITY FOR PROVING SUCH DOCUMENTATION NECESSARY TO SUPPORT THIS CERTIFICATE, AND TO STATE THAT THIS CERTIFICATE WAS GIVEN OF ANY CHANGES THAT COULD AFFECT THE ACCURACY OF THE CERTIFICATE.**

**MORE OF THE PARTIES, AND COMPLY WITH THE ORIGIN REQUIREMENTS FOR THE NORTH AMERICAN FREE TRADE AGREEMENT, AND UNLESS SPECIFICALLY EXEMPTED IN THE AGREEMENT, ANY PRODUCTION OR ANY OTHER OPERATION OUTSIDE THE TERRITORIES OF THE SIGNING PARTIES IS SUBJECT TO APPLICABLE DUTIES.**

**Including all attachments.**

**11b. COMPANY**

**11c. TITLE**

**11d. (Voice)**

**11e. (Facsimile)**

**11f. TELEPHONE NUMBER**

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*Customs Form 434 (040397)*
NAFTA Criterion A

Wholly Obtained or Produced

Wholly Obtained or Produced (from wholly obtained items)

- Goods wholly obtained or produced from wholly obtained goods, entirely in Canada, Mexico or the United States
- Contain no foreign materials from outside the NAFTA territory

- This is known as preference criterion “A” on the NAFTA Certificate of Origin
NAFTA Criterion A
Wholly Obtained or Produced

- Minerals extracted in the region
- Vegetable goods from the region
- Live animals born and raised in the region
- Regional Goods obtained from hunting, trapping or fishing
- Goods (fish, shellfish and other marine life) taken from the sea by vessels registered or recorded with CA, MX, or the US and flying its flag
- Goods produced on board factory ships ….provided such factory ships are registered in MX, CA or US, or recorded with that country and fly its flag
NAFTA Criterion A
Wholly Obtained or Produced

Goods taken from outer space, provided they are obtained by CA, MX or the US persons and not processed in a non-NAFTA country.

- This criterion typically applies to raw materials, or Goods made directly from raw materials.
  - Further manufactured goods would not qualify under this criterion unless the producer could trace all inputs back to raw materials originating in North America.
NAFTA Preference Criterion B
Meets Annex 401 Originating Rules

• NAFTA criterion B rules for origination - three types:
  – Change in tariff classification – “Tariff Shift”, or
  – Regional Value Content (RVC) requirement, or
  – Both a change in tariff classification and a regional value content

This is known as preference criterion “B” on the NAFTA Certificate or Origin
NAFTA – Preference Criterion B

Annex 401 – Tariff Shift Rules

**Tariff Shift**

• HS classification “Tariff Shift” is the basis for most NAFTA rules of origin

• Requires that non-originating inputs have a classification different from the classification of the finished product (based on the rule for that finished product)
NAFTA – Preference Criterion B
Annex 401 – Tariff Shift Rules

• To find a specific rule of origin and determine if the rule has been met, you must know:
  – The tariff number of your finished item, and,
  – The HTS numbers of all the non-NAFTA materials used to produce the good
Tariff Classification Numbers

Essential Harmonized System Terms Used In Origin Rules

• An HS number breaks down as follows:
  – Chapter 92 (2 digits)
  – Heading 9205 (4 digits)
  – Subheading 9205.90 (6 digits)*
  – Tariff item 9205.90.40 (8 digits)
  – Statistical 9205.90.4020 (10 digits)**

*Classifications are “harmonized” internationally at the subheading (6-digit) level
**U.S. classifications have 10 digits
NAFTA – Preference Criterion B
Annex 401 – Tariff Shift Rules

Criterion B Tariff Change Rule:

• Each of the non-originating inputs used in the production of the item must undergo the applicable change as a result of production occurring entirely in the NAFTA region

  – This means: non-originating inputs are classified under one tariff provision prior to processing and classified under another upon completion
NAFTA – Preference Criterion B
Annex 401 – Tariff Shift Rules

Tariff Shift Example:

- **Products:**
  - breads, pastries, cakes, biscuits (HS 1905.90)

- **Non-North American Input:**
  - Italian Flour (classified in HS Chapter 11)

- **NAFTA Rule of Origin:**
  - *A change to heading 1905 from any other chapter*
NAFTA – Preference Criterion B
Annex 401 – Tariff Shift Rules

Tariff Shift 2nd Example

- **Product:**
  - Frozen pork sausage (HS 1601)
  - produced in the U.S. from the following

<table>
<thead>
<tr>
<th>Ingredients</th>
<th>Country of Origin</th>
<th>HS headings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frozen Pork Meat</td>
<td>Hungary</td>
<td>0203</td>
</tr>
<tr>
<td>Spices</td>
<td>Jamaica</td>
<td>0907-0910</td>
</tr>
<tr>
<td>Cereals</td>
<td>United States</td>
<td>(not needed)</td>
</tr>
</tbody>
</table>
NAFTA – Preference Criterion B
Annex 401 – Tariff Shift Rules

• NAFTA rule of Origin:
  – A change to heading 1601 through 1605 from any other chapter
  – This is the correct rule for our final product

• Explanation:
  – Only non-originating materials must undergo the tariff change
  – Since frozen meat is classified in Chapter 2 and the spices are classified in Chapter 9, these non-originating materials meet the required tariff change
  – Cereal is not considered, since it is originating
NAFTA – Preference Criterion B
Annex 401 – Regional Value Content Rules

Regional Value Content Preference Rules

NAFTA Regional Value Content (RVC) rules require a specified percentage of North American content be included in the good

- There are two formulas for calculating RVC:
  - Transaction Value Method (60%)
  - Net Cost Method (50%)
NAFTA – Preference Criterion B

RVC – Transaction Value Method

Transaction Value Method:

\[ \text{RVC} = \frac{\text{TV} - \text{VNM}}{\text{TV}} \times 100 \]

**RVC:** regional value content (*expressed as a percent*)

**TV:** transaction value of the good (*adjusted to an FOB basis*)

**VNM:** value of non-originating materials used by the producer in the production of the good.
NAFTA – Preference Criterion B

RVC – Transaction Value Method Example

- Microwave Oven, HTS 8514.20, made in U.S. = $440US
- Japanese oven parts are HTS 8514.90= $177US

RULE applying to HTS 8514.20

A. A change to subheadings 8514.10 through 8514.40 from any other heading, or
B. A change to subheadings 8514.10 through 8514.40 from subheading 8514.90, whether or not there is also a change from any other heading, provided there is a RVC of not less than:

- 60% where the transaction value method is used
- 50% where the net cost method is used
NAFTA – Preference Criterion B

RVC – Transaction Value Method Example

Applying the RVC Transacting Value calculation for HTS 8514.20, the regional content would be calculated as:

\[
\left( \frac{440 - 177}{440} \right) \times 100 = 59.7\%
\]

Is the RVC Transaction Value percentage requirement met?
NAFTA

RVC – Net Cost Method

Net Cost RVC Method: Represents all of the costs incurred by the producer, minus:

– expenses for sales promotion (including marketing & after sales service)
– royalties
– shipping & packing costs
NAFTA – Preference Criterion B

RVC – Net Cost Method

\[ \text{RVC} = \frac{\text{NC} - \text{VNM}}{\text{NC}} \times 100 \]

**RVC:** regional value content, expressed as a percentage

**NC:** Net Cost of the good (Based on Bill of Materials)

**VNM:** value of non-originating materials used by the producer in the production of the good
NAFTA Preference Criterion C

NAFTA Territory Originating Material

- Goods also originate if they are produced entirely in CA, MX and/or the U.S. exclusively from materials considered to be originating

- This provision allows goods made of parts and materials that themselves meet NAFTA rules of origin, even though containing some non-North American inputs

- This is known as preference criterion “C” on the NAFTA Certificate of Origin
NAFTA – Criterion D

Unassembled Goods/Classified with their Parts

Under two limited circumstances, an item that has not undergone the required tariff change can still qualify for preferential NAFTA treatment if the Regional Value Content is 50% or 60% of the value, depending on which accounting method is used:

- Never used for wearing apparel, Chapters 61 - 63 (apparel and other made-up textile items such as blankets, linens and bags)
NAFTA – Criterion D
Unassembled Goods/Classified with their Parts

Two specific circumstances:

D1. *Goods imported in unassembled form:* The goods do not undergo a change in tariff because they are imported in an unassembled or disassembled form but are classified as assembled goods, under the same HS number.

D2. *Item/parts classified under same HS Number*
The country of origin of such good is the last NAFTA country in which that good underwent production other than minor processing,

- Provided that a Certificate of Origin (see § 181.11) has been completed and signed for the good.
Other Instances to Confer Origin

De Minimis: 7% solution

If a good does not qualify because one or more of the non-originating components fails tariff shift, then qualification could occur if the value of all non-originating materials used in the production of the good that do not undergo Tariff Shift is not more than 7 percent of the transaction value of the good, or, (if the transaction value is unacceptable)…, the value of all such non-originating materials is not more than 7 percent of the total cost of the good.
Intermediate Materials
In situations where a final product does not otherwise qualify, vertically integrated producers may be able to achieve qualification by qualifying sub-components at prior stages of production.

Accumulation
In situations where a final product does not otherwise qualify, qualification may be achieved by adding up the RVC of sub-components.

Fungible Goods & Materials
Methodology that could be used where the component inventory is composed of both NAFTA originating and non-originating components.
In Summary

NAFTA is “Rules Based”
Correct classifications are essential

NAFTA Preference Qualification Rules
- A (Wholly Obtained), B (Tariff Shift, RVC), C (all originating inputs), D (two special situations), (E and F too)
- de minimis (generally 7%) may work if Tariff Shift fails
- Use whichever rule works

NAFTA Country of Origin Rules (Customs Regs, Part 102)
- A-1 (Wholly Obtained), A-2 (All domestic inputs), A-3 (Tariff Shift Rules), B (essential character)

Management and auditing of NAFTA process is essential
- Recordkeeping, Certificate Management, Watching for changes
Best Practices

• NAFTA has a set Certificate
  – Similar “NAFTA Style” FTAs do not
  – Know Who Can Sign Document and Who is Liable for the Claim

• Preparing for an audit
  – What to maintain for records? How long?

• Pre determining if NAFTA should be claimed or not Base on Duty Rate into Receiving Country
Best Practices

• NAFTA Style Trade Agreements begin With Correct Classifications
  – First You Classify, then you Qualify
• Audit All Use of Trade Agreements within Your Firm
• Use Specific Qualifying Language for Trade Agreements
• Prepare for TPP
Questions?

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