

WORLD TRADE ORGANIZATION

G/RO/30
22 January 1999

(99-0229)

Committee on Rules of Origin

UNRESOLVED ISSUES FOR DECISION BY THE COMMITTEE ON RULES OF ORIGIN

Overall Architecture of the Harmonized Rules of Origin

The Technical Committee on Rules of Origin has submitted to the Committee on Rules of Origin (CRO) unresolved issues for decision by the CRO concerning the overall architecture of the harmonized rules of origin. The unresolved issues are herewith circulated to Members.

The CRO is invited to decide which approach is most appropriate for the articulation of the harmonized rules of origin.

ISSUE: When are the residual rules to be applied: when the primary rules applicable to the good have not been satisfied in any country involved in the production of the good, or, when the primary rules applicable to the good have not been satisfied only in the country where the last production process has taken place?

This referral stems from three differing approaches to the application of origin conferring primary rules.

The key difference is that under Option A the process of applying primary origin conferring rules does not stop until it has been determined that the applicable rule has not been satisfied with respect to any country. Under Options B and C the primary origin conferring rule(s) are only applied with respect to the good of which the origin has to be determined. If the primary rule is not satisfied in the country in which this good has been produced, the origin of that particular good is determined under the applicable residual rule.

Questions	Option A	Options B and C
What is the procedure used to determine the country of origin of a good which is to be exported from the country in which it was produced?	Apply Appendix 1 first. If origin is not determined, the primary rule applicable to the good determines the origin.	Apply Appendix 1 first. If origin is not determined, the primary rule applicable to the good determines the origin.

When the primary rule applicable to the good has not been satisfied <u>in the country of export</u> , how is the origin of the good to be determined?	<p>The primary rule shall be applied in any preceding countries. The country of origin is the country where the good last satisfied the primary rule.</p> <p>If the production of the good does not satisfy the primary rule, the residual rule shall be applied to determine the country of origin of that particular good.</p>	If the production of the good does not satisfy the primary rule, the residual rule shall be applied to determine the country of origin of that particular good.
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Note 1: In Option A the good is defined within the categories of the HS as agreed by the TCRO. In Options B and C the good is any good subject to a production process in the exporting country.

Note 2: Option C differs from B only in the content of proposed residual rules.

Note 3: Final detail of the residual rules are not provided by proponents of all proposals.

Illustrative example is annexed for easy comparison between the options.

OPTION A: Residual rules are to be applied only when none of the primary origin conferring primary rules applicable to the good is satisfied in any country involved in the production of the good.

1. Option A reflects the mandate of the Agreement on Rules of Origin that origin is to be determined by application of rules based on the principle of substantial transformation as expressed, for example, as a change of classification in the Harmonized System. The Agreement on Rules of Origin establishes a preference for the use of change in classification as the sole criteria for determining whether a substantial transformation has occurred. See paragraph 2(c)(iii) of Article 9 to the Agreement which provides: "...[W]here the **exclusive** use of the HS nomenclature does not allow for the expression of substantial transformation, the Technical Committee ... shall consider and elaborate upon, on the basis of the criterion of substantial transformation, the use, in a supplementary or exclusive manner, of other requirements..."

2. Primary rules were prepared based on whether a change in HS classification or the occurrence of a particular process of manufacture did or did not result in a substantial transformation of the materials in the good. These rules are explicitly based on the HS classification of the subject good. To limit their application only to the country of last production is arbitrary and inconsistent with the intention of the Agreement. Only if the production of a good has not satisfied the applicable primary rule in any country involved in its production should one need to resort to residual rules to determine the origin of the good. Obviously, the rule applicable to a good is the rule appropriate to its classification under the Harmonized System. Residual rules are only to be developed for and applied in those limited situations where the primary rules do not result in an origin determination for the good based on application of the primary rules.

3. Residual rules are intended to ensure that an origin determination is made in every case. They do not always reflect a substantial transformation for the good itself.

4. Application of the primary rules applicable to the good to any country involved in the production of the good will achieve the results intended by the primary rules. In addition, such

application will result in consistent origin outcomes irrespective of the order of manufacture or place of final shipment. Limiting the application of primary rules only to the last country of manufacture will often yield outcomes not intended by the Agreement or by the TCRO as the residual rules may be based on origin criteria different from the primary rule criteria. For example, if a good is shipped to a third country in which it undergoes a non-origin conferring process of manufacture, it will be subject to a different rule than if it were shipped directly to the country of final consumption. This approach allows origin to be conferred based on unwarranted deflections of trade. Such a result would be trade distorting and contrary to Article 2 (c) of the Agreement.

5. The application of primary rules provides greater certainty and predictability of result than do residual rules.

6. Customs and traders will be able to apply the primary rules regardless of the country where in the chain of manufacture the primary rules are satisfied for a good since origin declarations or other indications of origin are prepared in the normal course of business and accompany the goods as they move from country to country.

7. Application of the primary rules as suggested in this option will maximize the use of origin rules based on change in classification. This method facilitates the origin determination as traders and Customs must already indicate the classification of goods under the HS for tariff and other purposes. Resort to classification of the good is an easy and useful means for the articulation of origin rules.

8. Residual rules, many of which may be based on value standards, are in many instances more difficult to apply. Use of value standards requires information from foreign producers which may be difficult or time-consuming to obtain. Determining the cost of originating components when there is no transaction value (i.e., when the material is captively obtained) is subject to the vagaries of accounting systems which may vary from company to company. Further, value standards are influenced by currency fluctuations and other variables. Such standards suffer from a lack of predictability.

9. The residual rules should be applied only when no country has satisfied the primary origin conferring rules applicable to the good.

10. The relevant rules in the architecture of the Harmonized Non-Preferential Rules of Origin should provide :

General Rule 4:

1. The country of origin of a good shall be determined in accordance with the provisions of paragraph 2 of this General Rule, applied in sequence.
2. The country of origin of a good is the country in which:
 - (a) The good is wholly obtained as defined in Appendix 1;
 - (b) The good satisfies the applicable rule set forth in Appendix 2;

Paragraph 2 of Appendix 2:

2. The country of origin of a good shall be determined in accordance with the following subparagraphs, applied in sequence:
 - (a) the [last] country in which an origin conferring primary rule in this Appendix applicable to the good was [last] satisfied;
 - (b) the [last] country in which a residual rule *specified at a Chapter level (Sec)* in this Appendix applicable to the good was [last] satisfied;

- [(c) the [last] country in which a rule set out below was [last] satisfied:]
(GENERAL RESIDUAL RULES YET TO BE DETERMINED) (US) (CAN) (JPN)
(AUS) (SG) (SEN) (NZ) (HK) (EGY) (ARG) (THA) (COL)

OPTION B: Residual rules are to be applied if none of the primary rules applicable to the good is satisfied in the country where the last production process has taken place

11. Option B reflects the requirement of the Agreement on Rules of Origin that when more than one country is concerned in the production of the good, Rules of Origin should provide for the country to be determined as the origin of that particular good on the basis of the criterion of substantial transformation.
12. Primary rules are based on that criterion. They are applied to the good under consideration as it results from the processing or manufacturing carried out in the country of production. Their application shall be limited to that particular good.
13. Option B states that primary rules shall only apply to the good of which the origin has to be determined. Therefore, when the last transformation carried out in the country of production of that good is not substantial, origin is determined by means of residual rules.
14. Application of the primary rules to the good in a previous stage in upstream countries involved in the production or manufacturing of the good of which the origin has to be determined, will result in origin outcomes which, contrary to the mandate of the Agreement, may disregard the country where the last substantial transformation has been carried out.
15. Rules of Origin themselves should not create unnecessary obstacles to trade.
16. Determination of the origin of a particular good by applying the primary rules for that good to processing or manufacturing of intermediate goods in other countries than the country of production of the good of which origin has to be determined will require Customs and traders to use information concerning these processes which is not available in the normal course of business. Obtaining this information from foreign producers and administrations may be difficult and time-consuming.
17. In accordance with the Agreement on Rules of Origin, residual rules are also based on the principle of the last substantial transformation. When the last transformation carried out is not substantial, origin has to be determined on the basis of the penultimate transformation which is then considered to be the **last** substantial transformation. This penultimate transformation is the production of the materials incorporated. Residual rules give an answer to the question : “which of the materials used confer(s) origin on the good under consideration?”
18. Application of residual rules as suggested in this option will facilitate the origin determination by Customs and traders by requiring only information already available in the normal course of business in the country of production of that particular good (data available on import documents).
19. The relevant rules in the architecture of the Harmonized Non-Preferential Rules of Origin should provide :

General Rule 4 :

1. The country of origin of a good shall be determined in accordance with the provisions of paragraphs 2 and 3, applied in sequence.
2. The country of origin of a good is the country in which:
 - (a) the good is wholly obtained as defined in Appendix 1; or

(b) the good is obtained, provided it satisfies the applicable primary rule set forth in Appendix 2.

3. When the origin criteria laid down in paragraph 2 above are not met, the country of origin shall be determined in accordance with the residual rules set forth in Appendix 2.

4. Notwithstanding the provisions in paragraphs 2 b) and 3 above, non-originating materials that do not meet the primary rules set forth in Appendix 2 shall be disregarded in determining the country of origin provided that these materials do not exceed the threshold laid down in Appendix 2. This provision is hereinafter referred to as the “de minimis rule”.

Paragraph 2 of Appendix 2:

2. The country of origin of a good shall be determined in accordance with the following provisions, applied in sequence:

(a) the country of origin of a good is the country in which the good is obtained, provided the applicable primary rule set forth in this Appendix is satisfied there;

(b) when the primary rule is not satisfied in the country where the good is obtained, the country of origin shall be determined in accordance with the following general residual rules which are applied without prejudice to product specific residual rules for which provision is made below in this Appendix;

(i) when the good is obtained from materials of a single country, the origin of the good shall be that country;

(ii) when the good is obtained from materials of more than one country, the origin of the good shall be the country of the material or materials that give the good its essential character.

The following rules shall apply for determining the material or materials that are considered to give the good its essential character :

A. The good is an agricultural product (Chapters 1-24 of the HS)

(Proposal currently examined)

B. Other goods

(1) The essential character of the good shall be given by the material or materials originating in that country which accounts for the major part (by value, volume or weight, as specified at the Chapter level (*)) of the non-originating materials used. The value, volume or weight of materials of the same origin shall be taken together.

(2) Notwithstanding paragraph 1 above, the essential character of the good shall be given by the originating materials used, provided they represent at least 50 % (by value, volume or weight, as specified at the Chapter level (*)) of all the materials used. (EC) (NOR)

OPTION C: Residual rules are to be applied if none of the primary rules applicable to the good is satisfied in the country where the last production process has taken place

I. Principles

(*) The applicable unit of measure shall be chosen in function of the good and be mentioned at the appropriate place in the relevant Chapter. Example : Appendix 2, Chapter XY:

“Chapter Notes :

xx) For the application of the residual rules, the applicable unit of measure is the weight of the materials used.”

20. Residual rules have to be applied if a primary rule for a specific good is not met (See Swiss document : 42.697).

21. The objective of a primary rule is to confer origin to the country which has done the last substantial transformation on a good.

22. The origin determination is done on a good and not on its part(s). As a matter of fact, there is no knowledge whether the part(s) obtained its/their origin through fulfilling the corresponding primary rule or a residual rule. Therefore, there is **no knowledge where the last substantial transformation** according to Appendix 2 to Annex III of the Agreement **was achieved**. The only **known facts** are the **origin of the part(s)**.

23. A residual rule test must come to a **reasonable** and **final** origin result. A residual test can only come to a reasonable result if the test is done on the good for which the origin has to be determined.

24. The residual rule test is a new test of the determination of the origin of a good.

25. Non-originating¹ and originating² part(s) must have an equal status in determining the origin of the good. Manufacturing processes, overheads and profits are included in the value of the non-originating and originating part(s). The origin must however not be determined on these part(s) but on **a good made therefrom** ; whether one of these part(s) shall give its origin to the good will depend on the **relative importance** of :

- (i) the non-originating inputs (including the non-originating processing activities) by country for each part;
- (ii) the originating inputs including the originating processing activities related to the part(s) and to the good for which the origin is to be determined.

26. Due to the fact that the processing activities to produce the non-originating and the originating part(s) are considered, the processing activities combining the part(s) must also be considered . It would not be reasonable and fair for the country where the last production process has taken place to ignore them and to **limit the residual rule** to an **arithmetic comparison** of part(s) which may very well have obtained their origin through the application of a **residual rule**.

27. The residual rule must therefore focus on a good and **compare** non-originating and originating part(s) together with related processing activities. No value judgment can be made on the last substantial transformation of part(s) because they may have obtained origin through a residual rule.

II. Application

28. The residual rule applies to all chapters of the HS and should therefore be placed in a General Rule or in an Appendix 2 Rule. The residual rule must be simple and straightforward.

29. The residual rule provides directly and exclusively the final origin of the good.

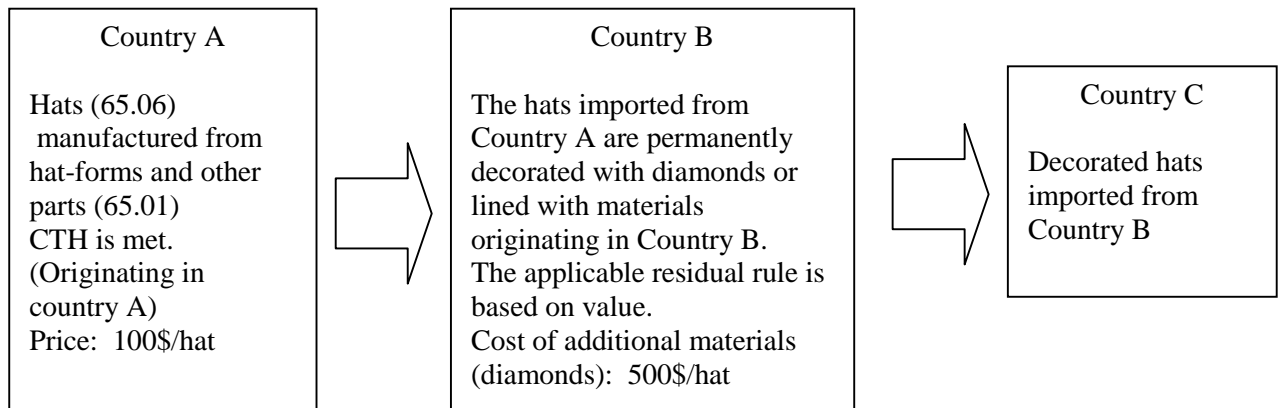
¹Part(s) not produced in the country where the last production process of the good takes place ; origin of the part(s) determined either with a primary or residual rule.

² Part(s) produced in the country where the last production process of the good takes place ; origin determined either with a primary or residual rule.

II. Rule

30. When the primary rule(s) - subject to the "de minimis"-rule- referring to a good is (are) not fulfilled, the country of origin shall be determined in accordance with the country contributing most to the good in terms of total value of part(s) and related processing activities. (CH)

ILLUSTRATIVE EXAMPLE
(Exercise undertaken by manufacturers in Country B)



When exporting decorated hats from Country B to Country C:

Option A:

Step 1: The primary rule for hats (65.06) is CTH.

In country B decorating hats does not change the classification of the hats. Thus origin is not conferred in Country B.

Step 2: The primary rule is applied in Country A as to whether CTH took place in Country A. Answer is yes.

Step 3: Origin is determined as Country A by the primary rule.

Options B and C:

Step 1: The primary rule for hats (65.06) is CTH.

In country B decorating hats does not change the classification of the hats. Origin is not conferred in Country B by the primary rule.

Step 2: Thus the residual rule shall be applied to the hats. The imported hats cost \$100, while the diamonds cost \$500.

Step 3: Origin is determined as Country B by the residual rule.
