



# Rules of Origin

**A Strategic Guide to Improved  
Competitiveness**



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# 1.0 Management Summary

For global companies that purchase raw materials and parts from different sources around the world, it is often difficult to identify the origin of manufactured products. This is especially important as it allows businesses to benefit from savings potentials and increased competitive advantages. “**Rules of origin**” are trade policy measures designed to help companies determine the origin of a product. This means that rules of origin are the criteria used by businesses to define where a product was produced. They are an important part of trade rules that aim to reduce trade barriers and boost international trade.

There is a distinction between **non-preferential and preferential origin** for customs matters. Non-preferential rules of origin are applied in the absence of trade agreements to determine the national source of goods. Preferential rules of origin apply in reciprocal trade agreements and grant tariff benefits to trading companies. More than 500 notified free trade agreements (FTAs) around the globe offer potential duty savings to companies.

The full potential of rules of origin often goes unutilized since not all businesses are able to benefit from these trade policy measures. To secure a long-term competitive advantage as a globally active company, it is therefore important to acquire an understanding of this complex topic. This will allow companies to optimize their worldwide customs processes and align global trade strategically.

However, it varies from industry to industry whether the use of rules of origin is advisable, especially when it comes to preferential origin and FTAs. Preferential treatment makes sense for industries with high customs duties and special compliance requirements. In combination with the right, efficient and automated IT solution, rules of origin offer many **benefits** for companies:

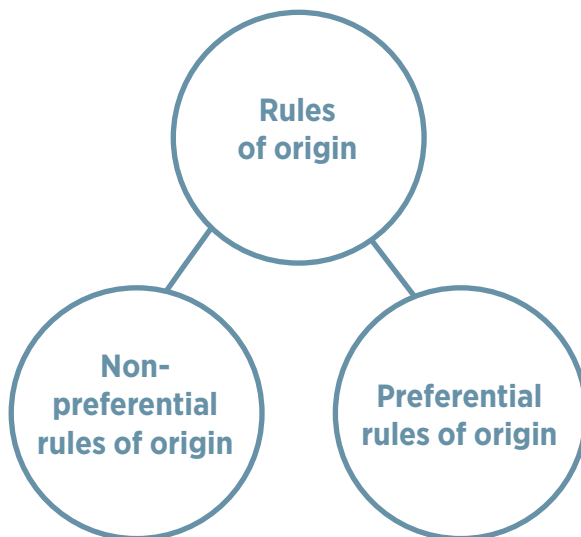
- 🌐 **Competitive advantage** (reduced trade barriers)
- 🌐 **Reduced risks** (increased automated processes)
- 🌐 **Time savings** (accelerated processes)
- 🌐 **Optimized resources** (focus on strategic activities)
- 🌐 **Cost savings** (avoidance of fines and unplanned costs)

To benefit from such trade policy measures, companies must first understand these complex rules. This white paper from MIC aims to provide an overview about rules of origin, offers tips for determining the non-preferential and preferential origin of products, and finally highlights the benefits for globally active companies.

## 2.0 Introduction to Rules of Origin

After classifying a product into the **harmonized system (HS)** and the determining its value, the determination of the country of origin is the third key element in customs clearance procedures. Rules of origin are the criteria needed to identify a product's origin. This means, it is possible for companies to find out where goods have been produced or manufactured, but not where they have been shipped from.<sup>1</sup>

Rules of origin were adopted under the auspices of the WTO (World Trade Organization) and the aim is for all WTO members to implement them transparently. There are two different categories of rules of origin:



**Non-preferential rules of origin** are applied in the absence of trade agreements to determine the national source of goods. The criteria for obtaining non-preferential origin status are set out in Article 24 of the **union customs code**. The WTO agreement on rules of origin aims to harmonize these rules in the long term.

In contrast, **preferential rules of origin** apply in reciprocal trade agreements (e.g. regional trade agreements or customs unions) and grant companies **tariff benefits**.<sup>3</sup> The terms for obtaining preferential origin are defined in the respective trade agreement between two or more countries.<sup>4</sup> There are already more than 500 notified **free trade agreements (FTAs)** around the world such as CETA, NAFTA / USMCA, JEFTA, EU-MERCOSUR, EU-UK, RCEP and many more that offer potential duty savings to companies.<sup>5</sup>

The two different rules for determining the origin of goods are explained in more detail below.



The **harmonized system (HS)** is an international multipurpose product nomenclature elaborated by the World Customs Organization (WCO). It comprises about 5,000 commodity groups which are identified by a 6-digit code and enables the classification of products.

The combined nomenclature of the European Union (EU) integrates the HS nomenclature and comprises additional 8-digit subdivisions.<sup>2</sup>



The **union customs code (UCC)** is a key element of the ongoing actions to modernize EU customs. It provides a framework for customs rules and procedures in the EU customs territory adapted to modern trade realities and modern communication tools.<sup>6</sup>



A **free trade agreement (FTA)** is a treaty between two or more countries with the goal of facilitating international trade and removing trade barriers. It aims to eliminate customs tariffs and create an open and competitive international market.<sup>7</sup>

<sup>1</sup> cf. European Commission 1

<sup>2</sup> cf. European Commission 2

<sup>3</sup> cf. World Trade Organization 1

<sup>4</sup> cf. European Commission 3

<sup>5</sup> cf. European Commission 9

<sup>6</sup> cf. European Commission 4

<sup>7</sup> cf. European Commission 7

## 2.1 Non-preferential Rules of Origin

**Non-preferential rules of origin** are used to determine the country of origin of goods in the absence of trade preferences. Non-preferential origin is also known as the “economic nationality of goods”. Basically, all products have a non-preferential origin, but only specific products from a particular country can obtain preferential origin.

The determination of non-preferential origin is linked to the **most-favored nation (MFN)** principle. The non-preferential treatment is applied in combination with policy measures such as quotas, anti-dumping and countervailing duties, trade embargoes, safeguard measures and quantitative restrictions. Moreover, non-preferential rules are also used for brand recognition (e.g. Swiss watch made in Switzerland), trade statistics and public tenders.<sup>8</sup> It is important to note that non-preferential rules do not lead to reduced tariffs.



The **most-favored nation (MFN)** treatment says that countries cannot normally discriminate between their trading partners. If a country offers benefits to one trading partner, it has to give the same “best” treatment to all the other WTO members.<sup>11</sup>

Although the WTO has established a set of rules for determining non-preferential origin, not all countries apply identical rules. The reason is that not all WTO members agree on harmonizing non-preferential rules, and not all of them apply national rules of origin for non-preferential purposes either.<sup>9</sup> For example, the EU applies its own set of non-preferential rules of origin, which may differ from those of other third countries.<sup>10</sup>

The non-preferential origin of goods is based on two criteria:

- 🌐 **Wholly obtained** from one country
- 🌐 **Last substantial transformation**

### How to determine the non-preferential origin?

But what exactly needs to be considered from a company’s perspective when it comes to determining non-preferential origin? A step-by-step approach for assessing the origin is provided below:

#### Step 1

The first step is to identify whether the goods were **wholly obtained** from **one** country or not. If only one country is involved in the manufacturing process of a good, the wholly obtained concept will be applied. The UCC clearly specifies what kind of goods shall be considered as wholly obtained in a country. Article 60 (1) UCC states that “*goods wholly obtained in a single country or territory shall be regarded as having their origin in that country or territory*”.<sup>12</sup>

For example, this rule is applied for vegetable products harvested in the respective country, live animals born and raised there or products from hunting and fishing.<sup>13</sup> If the goods are not wholly obtained from one country, the next step is to check what process the goods have gone through.

8 cf. World Trade Organization 1

9 cf. World Trade Organization 1

10 cf. European Commission 5

11 cf. World Trade Organization 3

12 European Parliament & Council of the European Union (2013), p. 32

13 cf. Council of the European Union (1992), p. 17

## Step 2

If **two or more** countries are involved in the production of goods – meaning the goods are not wholly obtained from one country – the concept of **last substantial transformation** determines the origin of the goods. This means that the goods need to go through a fundamental change as a result of processing or manufacturing in the country claiming origin.<sup>14</sup>

Article 60 (2) UCC provides that “*goods the production of which involves more than one country or territory shall be deemed to originate in the country or territory where they underwent their last, substantial, economically justified processing or working, in an undertaking equipped for that purpose, resulting in the manufacture of a new product or representing an important stage of manufacture*”.<sup>15</sup>

## Step 3

To identify the origin, it is necessary to look at the respective customs regulations as the third step. The customs regulations are country-/region-specific, for instance, this means that the EU and Switzerland have established individual rules (e.g. the UCC in the EU). Some products must undergo a specific process defined by rules in the customs regulations to obtain non-preferential treatment. These regulations specify **what process** the goods have to undergo in order to obtain non-preferential origin.

## Step 4

If there is no specification for processing the goods, it is suggested to find out **where** the last substantial transformation took place. In this case, checking the **tariff heading** helps to see whether the products' last processing was more than just a minimal process. By comparing the commodity code of the goods before and after the transformation process, it is possible to determine whether the codes have changed. A **changed tariff heading** indicates that substantial processing took place.

## Step 5

If it is still unclear where the non-preferential origin of the goods is, operators can apply for a **binding origin information (BOI)** decision from customs authorities. Such decisions are binding on the holder as well as on the authorities.<sup>16</sup>



Competent authorities can issue **binding origin information (BOI)**, which is binding for the holder and customs authorities in all EU Member States. This document is valid for 3 years from the date of issue.<sup>17</sup>

<sup>14</sup> cf. Council of the European Union (1992), p. 17 f.

<sup>15</sup> European Parliament & Council of the European Union (2013), p. 31

<sup>16</sup> cf. European Commission 6

<sup>17</sup> cf. European Commission 1

## 2.2. Preferential Rules of Origin and Free Trade Agreement Management

**Preferential treatment** is granted in the combination with **free trade agreements (FTAs)**. Free trade agreements between two or more countries or regions aim to reduce trade barriers and facilitate international trade. Preferential rules of origin grant companies **tariff benefits** in terms of reduced or zero duty rates on goods.<sup>18</sup> This only applies to goods that originate in the trading partner country.

Preferential origin is only applied on goods from specific countries that fulfil certain **criteria** defined in the respective agreement. Under EU trade agreements, preferential tariff treatment is granted if specific criteria apply to the goods:<sup>19</sup>

- 🌐 **Wholly obtained or produced in the originating country**
- 🌐 **Undergone specifically determined working or processing**
- 🌐 **Products produced exclusively from materials originating in that country or products produced using non-originating materials provided they satisfy all applicable requirements**

This means that if the goods can be assigned to one of these criteria, they are regarded as “originating”. However, the criteria may differ depending on the free trade agreement in use.

Additionally, agreements include lists that define the working or processing a manufactured product from non-originating materials must undergo. The annex to each agreement sets out the so-called “list rules” and contains introductory remarks to those rules. These list rules specify the least amount of working or processing that is required for non-originating goods to obtain originating status and thus tariff benefits.<sup>20</sup>

The list of working or processing requirements is based on the structure of the harmonized system (HS). For companies to be able to determine the working process of a specific good it is important to know its HS classification.<sup>21</sup>

Therefore, it is advisable to always check the agreement in advance, to identify whether the materials fulfil the conditions laid down in the agreement.



The European Commission also offers a **guideline to the proof of origin**. This document includes an overview of links to online information and tools on customs and preferential rules of origin: [https://ec.europa.eu/taxation\\_customs/sites/default/files/01\\_2019\\_guidance\\_preferential\\_origin.pdf](https://ec.europa.eu/taxation_customs/sites/default/files/01_2019_guidance_preferential_origin.pdf)

<sup>18</sup> cf. European Commission 7

<sup>19</sup> cf. European Commission 10

<sup>20</sup> cf. European Commission 11

<sup>21</sup> cf. European Commission 7

## Free Trade Agreements

There are currently more than 500 notified **free trade agreements (FTAs)** in use around the world, which are often complex and hard to handle without knowledge, resources, and sophisticated internal customs processes. Trade agreements such as USMCA, CETA, JEFTA, EU-MERCOSUR, EU-UK, RCEP and many more are designed to create better trading opportunities and reduce trade barriers globally.<sup>22</sup> In 2019, EU trade under FTAs accounted for 32.4% of all EU trade with third countries, as can be seen in Figure 1.

But many companies are not aware of the large number of FTAs available and are therefore not able to benefit from them. From a strategic perspective, free trade agreements can be seen as a strategic management tool for businesses to improve their competitiveness in the long run. This is also reflected in the increase in preferential trade under free trade agreements. Between 2018 and 2019, EU preferential trade increased by 3.4%, compared to 2.5% growth with the rest of the world, as shown in Figure 2.<sup>23</sup>

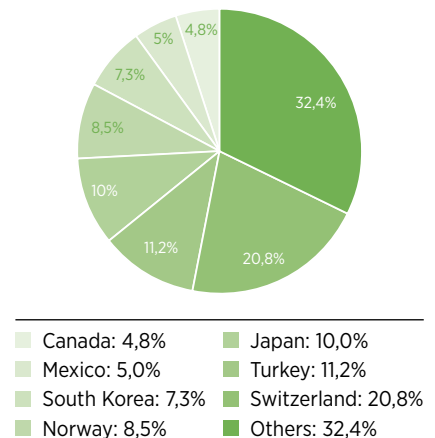
By adopting compliant origin calculation processes, companies can optimize global customs processes, avoid possible fines and unplanned costs. But how is it possible to benefit from preferential tariff treatment? Companies need to consider free trade agreements as early as during the supply chain planning phase in order to take the right strategic actions. It is important to know that only businesses that trade between countries which have an agreement (e.g. bilateral and regional trade agreements, or customs unions) or where one side has granted this autonomously (unilateral preferential trade) can benefit from preferential trade.<sup>24</sup> Unilateral preferential trade agreements especially aim to make it easier for **least developed countries (LDC)** to qualify for preferential treatment. This offers them the possibility to open up new markets and to better exploit the market potential.<sup>25</sup>

Each individual free trade agreement has its own legal base that specifies the provisions for the proof of origin and describes the procedure for issuing the proof of origin. More than half of the FTAs provide several different certification procedures which allow traders to choose the appropriate option.<sup>26</sup> Goods must fulfil the relevant conditions defined in the origin protocol to the agreement of the related countries or in the origin rules of the autonomous arrangements.<sup>27</sup> The procedures for presenting proof of origin to the respective customs authority of the importing country is also defined within an FTA. Finally, the proof of origin (origin declaration) is required for the application of preferential tariff treatment.<sup>28</sup>



The WTO provides a database with information about **regional trade agreement**. This enables companies to retrieve information about trade agreements that are in force, inactive or under negotiation: <https://rtais.wto.org/UI/PublicMaintainRTA-Home.aspx>

Figure 1:  
**EU trade in goods by preferential partners (2019)**



**Least developed countries (LDC)** are defined as low-income countries that are confronted with barriers that impedes sustainable development. LDC are highly sensitive to economic and environmental shocks and have low human capital.<sup>29</sup>

Figure 2:  
**Annual trade growth by FTA partners and all partners of the EU (2018-2019)**



22 cf. European Council

23 cf. European Commission 8

24 cf. European Commission 7

25 cf. World Trade Organization 2

26 cf. World Customs Organization 1 (2020), p. 12

27 cf. European Commission 7

28 cf. World Customs Organization 1 (2020), p. 13

29 cf. United Nations



## How to determine preferential origin?

When determining the preferential origin of goods, there are some important aspects to bear in mind for trading companies in certain industries. Which steps are necessary for these companies, which documents have to be submitted to the customs authority, and how innovative IT solutions can support them in this process are explained below:

### Step 1

To find out whether the goods qualify under preferential treatment, the exporter needs to **classify the goods under an appropriate HS code**. Afterwards, the exporter can check whether the commodity code is included in the rules of origin of the respective free trade agreement or not. The **goods must fulfil specific criteria laid out in the agreement**, as mentioned before.

### Step 2

If the goods meet the origin criteria of the FTA, they can be imported under preferential treatment. The **preferential tariff** is to be **claimed by the importer at the time of import**. If the importer does not know how the good was produced, it is possible to request a **supplier's declaration** from the exporter. This is additional evidence for the importer confirming that the products meet the origin criteria under a specific agreement.

### Step 3

In the third step, the exporter needs to **provide the importer with a certificate of origin**. This certificate needs to be issued either by the company itself, if it has obtained the status of an **authorized economic operator (AEO)**, or by the correct authority – again, this depends on the FTA. It is the exporters' responsibility to make sure that the goods qualify under preferential origin.

### Step 4

Additionally, other conditions such as **invoicing** and **shipping** need to be fulfilled by the exporter and the respective documents provided to the importer. These documents as well as the **import declaration** are also necessary for the importer to be able to claim preferential origin for the imported goods.

### Step 5

After receiving the required documents from the exporter, the importer can **claim the preferential tariff treatment**. An automated software solution for optimized free trade agreement management supports companies at this step, as such a solution also enables direct electronic transfers with national customs authority systems. Finally, claiming preferential tariff treatment allows the importer to **import the goods under a lower customs duty rate**. Since the importer is the one who benefits from preferential rules of origin, it is also the importer who is responsible and liable for the correctness of the origin documentation.<sup>30</sup> However, depending on the FTA, the importer and/or the exporter is/are required to retain all documents for a certain period (retention period).

## 3.0 Benefiting from Rules of Origin

Rules of origin, especially preferential rules, include several advantages for globally trading companies. However, the implementation of free trade agreements (FTAs) strongly depends on the industry. Trading under FTAs is reasonable for industries with high customs duties and specific compliance requirements. In combination with the right, efficient and automated IT solution, rules of origin provide many benefits for companies:

**1**

### Competitive advantage

Facilitating global trade and creating an open marketplace is the core idea behind rules of origin. Worldwide operating companies can take advantage of global trade opportunities in the form of reduced **trade barriers and low or zero duty rates** under preferential trade agreements.

**2**

### Reduced risks

Focusing on rules of origin and the possibilities of utilizing non-preferential and preferential tariff treatment should already take place in the early planning phase. Especially by **automating formerly manual customs processes** via innovative software solutions, compliance with the legal framework can be ensured in day-to-day operations.

**3**

### Time savings

If companies take a closer look at the topic of rules of origin, this can ultimately have a positive effect on the entire customs process. The **implementation of a suitable best-practice software solution** can also save a considerable amount of time during customs clearance. Time-consuming and manual customs processes are a thing of the past.

**4**

### Optimized resources

Considering free trade agreements as early as during the supply chain planning phase is important, as companies can **take the right strategic measures and optimize the use of their resources** at an early stage. This offers companies, operating in a specific industry, the opportunity to adapt their supply chain and production sites to the requirements of a specific free trade agreement.

**5**

### Cost savings

By trading compliantly under rules of origin, companies can **avoid possible fines and unplanned costs** in advance. Moreover, preferential rules may grant some companies tariff benefits in terms of **reduced or zero duty rates** on goods.

## 4.0 About MIC

### Your Specialist for Customs & Trade Compliance Software Solutions

MIC is the world leader in providing global customs and trade compliance software solutions. When MIC was founded in 1988, we had a vision: the development of a software solution for handling global customs processes. Today, over 33 years later, the vision has long become reality. MIC has established itself as a global brand and is the market leader in the global customs and trade compliance software sector. At the same time, MIC has grown continuously, geographically as well as in turnover and number of employees, today we are 400+ employees strong, and still growing. More than 700 international customers on 6 continents rely on MIC software products for their global customs and trade compliance management solutions.

For more information about MIC and how we can support you, please contact us via [sales@mic-cust.com](mailto:sales@mic-cust.com).

#### **MIC Datenverarbeitung GmbH**

Hafenstraße 24  
A-4020 Linz  
Tel +43(70)77 84 96-0  
Tel +43(70)77 84 96-600  
E-Mail [office@mic-cust.com](mailto:office@mic-cust.com)  
[www.mic-cust.com](http://www.mic-cust.com)



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