EU-UK Trade and Co-operation Agreement

Overview of Rules of Origin

Part 2, Heading 1, Title 1, Chapter 2

January 2021

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Executive Summary

<u>Who should read this document?</u>
This document is intended for those concerned with the cost and compliance implications of trading with companies located in the EU, and for those who manage indirect tax issues. It is also intended for those who oversee logistics and supply chains or who have a responsibility to generate shipping paperwork.

Further to the newly implemented EU-UK Trade and Co-operation Agreement between the UK and EU, this document is the first to be published by Clover Group designed to address the likely impact to companies who wish to trade and deliver goods from the UK to EU destinations post 1st January 2021. It does not assess the EU-UK Trade and Co-operation Agreement in its entirety, nor even the entirety of the section of the agreement which deals with trade (Part 2, Heading 1, Title 1).

Due to the fact that this new legislation on trade covers a very broad range of issues, it has been necessary to keep the remit of this document as narrow as possible. However, this is with a view to publishing further documents as is necessary to further expand the discussion and understanding of trade in the context of Part 2, Heading 1, Title 1 of the agreement.

As a result, there are a good many trade-related elements of the Agreement which are deliberately not addressed at this time. These include (but are not limited to), the Goods Vehicle Movement System (GVMS), the temporary Northern Ireland arrangements, Economic Operators Registration and Identification (EORI) Numbers or Authorised Economic Operator (AEO).

This document focusses primarily on Chapter 2 of Part 2, Heading 1, Title 1 (Article ORIG.1 and Article ORIG.2), concerning **Rules of Origin**.

In particular, this document assesses when the tariff free circumstances apply, in addition to addressing some significant requirements in the process for achieving these tariff free deliveries to and from EU destinations. It is important that companies trading with the EU understand this so as to avoid potential duties, penalties and delays to their supply chains with the EU.

The new rules are very product and industry specific, meaning companies who import and export goods will experience different impacts as a result of the new agreement, depending on their profile and that of their respective supply chains. As such, each company must make a detailed and informed decision as to what benefits the new agreement will bring to them, and what risks should be managed or avoided.

Clover Group remains available to industry to provide additional support as required. Please see the contacts section at the end of this document for further information.

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1.0 Overview

The publication and ratification of the EU-UK Trade and Co-operation Agreement was undoubtedly a significant outcome to the negotiations that took place in the run-up to the end of the Brexit transition period on 31st December 2020.

The timeframe between publication and implementation of this legislation was unprecedentedly short, and as follows:

24th December 2020	Announcement of an agreement and its publication in draft format
28th December 2020	Ratification of the agreement into EU law
30th December 2020	UK Parliamentary approval into UK law
31st December 2020	EU/UK Implementation Period comes to an end at 23.00 GMT
1st January 2021	Live implementation of the agreement

1.1 Background

A frequently discussed element of a proposed agreement in the public discussions during the 2020 negotiations was free trade and the movement of goods between the EU and UK. Although the UK Government took the initial decision to offer industry a "Delayed Declaration" facility until the 1st July 2021*, the same was not true of goods entering the EU from the UK after the transition period.

In order for this to happen, a trade deal between the two was required which allowed tariff free movement of goods, and which also set out the associated rules.

Upon publication of the draft EU-UK Trade and Co-operation Agreement, it became evident that such an arrangement was going to exist, and that tariffs and quotas would not be applied under many circumstances.

Notwithstanding this, it was clear that the agreement's structure would need to be just as committed to the integrity of the trade arrangements as it would to ensuring free trade. As such, it could not risk providing a "back-door" to market access for either party, meaning strict rules around areas such as the origin of goods would be required.

** The Delayed Declaration period only defers the requirement for a Supplementary Declaration and / or the payment of duties for six months. This is likely to be subject to a similar discussion document from Clover Group closer to the time.*

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2.0 EU-UK Trade and Co-operation Agreement

Part 2, Heading 1, Title 1 of the EU-UK Trade and Co-operation Agreement addresses the Trade in Goods between the UK and EU. Sub-Chapter 1 of this title enables the basic principle of market access, meaning trade in goods can continue without import tariffs or quotas being applied by either party, providing necessary criteria around the origin of goods are met.

2.1 Rules of Origin

Sub-chapter 2 to Title 1 addresses the Rules of Origin which must be met in order to be able to import goods tariff and quota-free between the two territories (these are referred to as "Parties" in the agreement). The Rules of Origin provide clarity over whether or not goods qualify as "originating" from the EU/UK and therefore qualifying for the relief.

The reasons behind having Rules of Origin requirements are to prevent any un-related trade agreements of either party allowing a flow of goods to the other party under the EU-UK Trade and Co-operation Agreement, and in doing so circumnavigate any would-be tariffs and/or quotas if the goods had been directly imported to the final party of delivery.

Example: If a company in either the UK or EU imported goods from a third country using an existing trade agreement, they could potentially do so without tariffs or quotas (import duties or limits on the amounts of imports, respectively). From this point, the Customs formalities on the goods have been resolved, and they are available to be freely traded once more.

Without Rules of Origin, the EU-UK Trade and Co-operation Agreement could be invoked to sell these goods to the other party without tariffs or quotas. However, it may be the case that the original country of supply does not enjoy the same relaxations over tariffs and / or quotas with the party of final delivery. In this instance, a direct supply from the originating country to the party of final delivery would have resulted in the goods being subjected to additional trade barriers.

Rules of Origin prevent either party to the Trade and Co-operation Agreement from relinquishing control over tariffs and quotas, by establishing the criteria by which either party can claim that the goods originate from that party, and therefore qualify for import relief under the EU-UK Trade and Co-operation Agreement.

2.2 Originating and Non-originating Status

The originating status of the goods is quite simply whether they can be considered to be UK or EU origin goods through qualification under the Rules of Origin. Originating goods are goods which originate in a party subject to the agreement (i.e. the UK or an EU country). Non-originating goods originating from a different, 3rd county.

This is determined by the exporter, and a declaration is made to the importer, prior to the goods being exported (see Documentation).

2.3 Materials

When assessing whether a good has originating status, one area which requires immediate clarity is the relationship between the identity of the finished good, as opposed to those of its components.

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In the Trade and Co-operation Agreement, these components are referred to as "Materials", and are defined as follows:

"material" means any substance used in the production of a product, including any components, ingredients, raw materials, or parts;"

An important point to consider at this stage is that there exists a broad spectrum by which finished goods may consist of numerous component parts and complex assembly profiles, or conversely have little or no identifiable materials in their makeup. The mechanism for identification in this Customs context is the Harmonised System (HS) for classification.

Example: Some finished goods which UK manufacturers and producers export are items which require multiple sub-assemblies and component parts ("materials"). Some of these materials may be "originating materials", some may be "non-originating materials", and all are identifiable through the Customs HS code.

These materials are processed and assembled as part of the manufacturing process and become identifiable through the HS code as a new item. In this instance, the finished product is a different item to the non-originating materials originally imported.

However, in other scenarios, there may exist little or no change in identity between non-originating materials and the finished product. In an extreme example, a supplier of goods may import the wholly finished product from overseas ready for immediate sale without any further processing. In this case, the finished good will have the same Customs identity through the HS code as the non-originating material initially imported. There will also exist cases where the non-originating materials still undergo some degree of processing after import and yet still retain the same identity. For example, food manufacturers who imported live animals or raw foodstuffs with a view to re-exporting them in a minimally altered state, or possibly textile producers who import large amounts of raw textiles to be cut and redistributed would potentially remain within the same HS code.

This relationship between materials and the finished good, particularly when the materials are non-originating materials is a key element when claiming preference under the Trade and Co-operation Agreement.

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3.0 Claiming Preference

There are 3 circumstances in which goods can hold originating status and would therefore qualify for tariff preference on import by either the UK or EU. These are:

1) Wholly Obtained Goods
2) Goods produced using originating materials (exclusively)
3) Goods which contain non-originating materials, but which have acquired originating status.

1) Wholly Obtained

To claim that goods are Wholly Obtained is to say that they are produced in the exporting party. As such, these types of products will often be base items or raw materials.

Example: Wholly Obtained goods could be (amongst other things) home-grown vegetables or plants, minerals extracted from the ground or seabed in the party's territory, live animals (born and raised in the party country) or certain waste and scrap items originating in the party country.

Wholly Obtained goods have an entirely single-country heritage, and it cannot be claimed that any other country has contributed to its production.

2) Goods produced using originating materials (exclusively)

In this scenario the products may be of a more complex nature and may have ingredients or component parts. Nevertheless, in order to make use of tariff preference under this circumstance, all materials would need to originate in the UK or the EU. The exporter will need to demonstrate (most likely with the use of Supplier Declaration forms – See Documentation), that the end-product contains only originating materials.

3) Goods which contain non-originating materials, but which have acquired originating status

There are 4 main criteria by which goods containing non-originating materials could acquire originating status under the Product Specific Rules of Origin. These are:

I. Change in Tariff Classification
II. Maximum Value of Non-originating Materials
III. Maximum Weight of Non-originating Materials
IV. Cumulation of Origin through a Production Process

The primary means of ascertaining whether criteria are satisfied can be found in Annex ORIG-2: *Product Specific Rules of Origin*. The specific rule(s) is found in column 2 of the table, against the corresponding Customs tariff heading.

In order to claim tariff preference under one of these criteria, the importer and exporter have certain responsibilities over the veracity of the origin status and must make additional declarations accordingly (See Responsibilities).

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I. Change in Tariff Classification

If non-originating materials have been imported to be integrated into a larger assembly, it is very possible that each of the non-originating materials will lose their original Customs identities. In this case, the new, larger assembly that has been produced results in a new Customs identity (through the HS code) being generated.

In these circumstances when the non-originating materials have changed their HS code, the newly produced item qualifies as an originating good, and is therefore eligible for tariff preference.

The table in Annex ORIG-2: *Product Specific Rules of Origin* itemises each commodity, as listed in the Customs tariff, along with Product Specific Rules in relation to the level of similarity permitted between the identity of the non-originating material and the finished product. This is an important distinction, as some products are not considered to be applicable non-originating materials until the tariff classification reaches the 6th digit level description of the HS code, some when matched at the 4th digit, and some are matched and therefore caught right at the first 2 digits (meaning non-originating material must change its final Customs identity to a different chapter before it qualifies as originating).

In the table in the Annex, these are identified as follows:

- CC 2-digit level
- CTH 4-digit level
- CTSH 6-digit level

II. Maximum Value of Non-originating Material

In instances where the finished product contains non-originating material which has not changed its identity, the Trade and Co-operation Agreement makes an accommodation for finished products to qualify as originating in Annex ORIG-2: *Product Specific Rules of Origin*.

The table in this annex identifies the maximum value of non-originating materials permitted as a percentage of the total EXW price of the finished good. This maximum value is referred to as the "MaxNOM".

In order to calculate the MaxNOM, the exporter must have two pieces of information available, the first being the value of the non-originating materials contained in the product. This is referred to as the "VNM".

The VNM is the **cost** of the goods at the time of importation from the non-originating country. This cost must include the purchase price of the material, the freight costs, packing costs, and any other costs paid to enable its arrival to the importing port or airport, along with any transit insurance paid.

There are other mechanisms available to establish the VNM in cases where the original costs are not known or not available.

The second piece of information needed is the Ex-Works (EXW) **sale** price of the goods. This is the produced (un-dispatched) value of the goods and should incorporate all production costs incurred plus profit.

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There are other mechanisms available to establish the EXW price in cases where the goods are not being sold, or where the sale price does not reflect all production costs.

The MaxNOM is then calculated by dividing the VNM by the EXW price and multiplying by 100, as follows:

$$\text{MaxNOM (\%)} = \frac{\text{VNM}}{\text{EXW}} \times 100$$

The MaxNOM can then be used in accordance with the table in Annex ORIG-2: *Product Specific Rules of Origin* in order to establish whether they exceed the stated threshold for the product being exported.

III. Maximum Weight of Non-originating Materials

Some finished products can still be considered as originating if they fail to satisfy the requirements of the Product Specific Rules of Origin, based on the weight content of the non-originating material.

However, this method (referred to as “Tolerances”) can only be used for limited products, namely; some foodstuffs contained in Chapter 2 and Chapter 4 – 24 of the HS code (excluding certain parts of Chapter 16), and also textiles in Chapters 50 – 63.

In this instance, finished products can be considered originating if the overall weight and value of non-originating materials do not exceed the stated thresholds. Other rules related to textiles must also be observed.

Reference to weight in a product-specific rule means the net weight, which is the weight of a material or product, not including the weight of any packaging.

IV. Cumulation of Origin through a Production Process

Cumulation of Origin might be used as a factor in determining whether goods have originating status. Among other things, Cumulation of Origin can occur when production processes have been carried out on the non-originating material in a party (and clearly when a change in tariff classification on the non-originating materials has not occurred).

There are certain circumstances listed which are not permitted as production processes capable of qualifying non-originating materials as originating; examples are listed in Paragraph 1 of Article ORIG-7: *Insufficient Production*.

However, production processes which are “simple” do not qualify as processes capable of changing non-originating materials to originating. Operations are considered simple if they do not require:

- Special skills
- Specialist machinery, apparatus or equipment especially produced or installed

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4.0 Responsibilities

Article ORIG.18(1): *Claim for preferential treatment* clarifies that the importer of the goods is responsible for the accuracy of the declaration submitted to the relevant Customs authority.

Use of tariff preference under the Trade and Co-operation Agreement is subject to audit, and in the event of incorrect claims being made, the importer will be liable for payment of any duties that should have been paid, at the exchange rates applicable at the time of import.

As a minimum, an importer must hold either a Statement on Origin (See Documentation) which is supplied by the exporter, or documentary evidence to support that the "Importer's Knowledge" of the goods can adequately demonstrate that the goods are originating goods.

If such documentary evidence cannot be obtained for any reason (such as commercial sensitivities), then the importer should revert to obtaining a Statement on Origin from the exporter if it wishes to claim tariff preference.

Prior to completing and signing a Statement on Origin, the exporter of the goods must ensure that they can themselves evidence whether the finished good being exported is originating. When this is as a result of the goods first being obtained from another supplier on the same country (i.e. as a domestic purchase prior to export under the Trade and Co-operation Agreement), the exporter will need to obtain a Supplier's Declaration form in order to establish origin.

In turn - domestic suppliers may going forward need to complete Supplier's Declaration forms for domestic sales.

The importer must make the claim for preference at the time of import on the declaration submitted to the Customs authority, although a provision is available to retrospectively apply tariff preference in instances where it was applicable but not used.

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5.0 Documentation

As with any export that requires a Customs declaration, the shipper is required to complete an export / commercial invoice with the shipment.

For shipments where tariff preference is being claimed, a Statement on Origin must be supplied.

The Statement on Origin can be issued on a shipment-by-shipment basis, or, to cover multiple shipments within a 12-month maximum period (after 12 months a new Statement of Origin should be supplied).

If the Statement on Origin is being issued on a shipment-by-shipment basis, it may be incorporated as a statement onto the commercial invoice.

5.1 Statement on Origin

A template of the Statement on Origin is provided (for goods originating in the UK) in the Trade and Co-operation Agreement and is as follows:

English Version

(Period: From………………to ……………….)

The exporter of the products covered by this document (Export Reference No……………….) declares that, except where otherwise clearly indicated, these products are of UK preferential origin.

…………………………………………………………….
(Place and Date)

…………………………………………………………….
(Name of the exporter)

If the period is not applicable (such as if it is a one-time Statement on Origin) it may be omitted. The place and date may also be omitted if the statement is contained on a document that already shows this (such as on the commercial invoice).

When domestically obtained materials, which do not change tariff heading and for which tariff preference is intended to be claimed, exporters must make enquiries with the domestic supplier as to the origin of the materials supplied as part of the decision-making process.

This should be obtained by using a Supplier's Declaration, two version of which are provided in the Trade and Co-operation Agreement (ANNEX ORIG.3 APPENDIX 1).

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The first is a single declaration. It is intended to support one-time purchases where the supplier is confirming the origin status of the materials being supplied.

The template for UK domestic suppliers supplying to UK exporters to the EU is as follows:

5.2 Supplier's Declaration

SUPPLIER'S DECLARATION

I, the undersigned, the supplier of the products covered by the annexed document, declare that:

1. *The following materials which do not originate in the UK have been used in the UK to produce these products:*

Description of the products supplied	*Description of non-originating materials used*	*HS heading of non-originating materials used*	*Value of non-originating materials used*
		Total value	

2. *All the other materials used in the UK to produce those products originate in the UK.*

I undertake to make available any further supporting documents required.

………………………………………………………………………………… *(Place and Date)*

………

………………………………………….. *(Name and position of the undersigned, name and address of company)*

……………………………………………………………….. *(Signature)*

The second template provided in the Trade and Co-operation Agreement is a Long-Term Supplier's Declaration (ANNEX ORIG.3 APPENDIX 2).

This declaration allows more regularly supplied materials which are supplied over a longer-term arrangement to be declared by the supplier and updated periodically.

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5.3 Long-term Supplier's Declaration

The template for UK domestic suppliers supplying on a long-term basis to UK exporters to the EU is as follows:

LONG TERM SUPPLIER'S DECLARATION

I, the undersigned, the supplier of the products covered by the annexed document, which are regularly supplied to …………., declare that:

1. *The following materials which do not originate in the UK have been used in the UK to produce these products:*

Description of the products supplied	*Description of non-originating materials used*	*HS heading of non-originating materials used*	*Value of non-originating materials used*
		Total value	

2. *All the other materials used in the UK to produce those products originate in a Party - UK / EU (delete as appropriate).*

This declaration is valid for all subsequent consignments of these products dispatched from dates ……………………… to ……………………

I undertake to inform …………………………………………………………………………………………………….. immediately if this declaration ceases to be valid.

………………………………………………………………………… (Place and Date)

……

…………………………………………. (Name and position of the undersigned, name and address of company)

……………………………………………………………….. (Signature)

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6.0 Likely Audit Requirements

Article ORIG.18(3): *Claim for preferential treatment* requires importers to keep records which demonstrate how any import entered to preferential tariff procedures have qualified as such.

This can be as a result of receiving a Statement on Origin from the exporter, or using the importer's knowledge, which would include supporting documentary evidence.

All documentation used to evidence originating status of the goods must be made available for audit by the domestic Customs authority.

That said, it is likely that Customs audits, particularly around preference will extend to export documentation to ensure mutual compliance between the EU and UK.

As a result, Customs authorities may wish to see evidence of processes employed by the importer / exporter to safeguard the integrity of preference decisions in areas such as:

- Bill of Materials (BOM) assessment
- Supplier questionnaire
- New supplier onboarding
- Decision making matrix

All available shipping documentation (invoices, transport documents, etc) should be made available, along with copies of Customs declarations, as well as decision-based documents used for export, such as purchase orders, purchase invoices, etc.

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7.0 FAQs

What has happened?

An agreement on Trade and Co-operation was reached between the EU and UK on 24th December 2020. This is called the EU-UK Trade and Co-operation Agreement.

Why was this necessary?

Following the Brexit referendum in 2016, the UK left the European Union at 23.00 GMT on 31st January 2020. The UK continued to operate to EU rules and agreements during an 11-month transition period which came to an end on 31st December 2020. Negotiations on an agreement took place between UK and EU throughout the transition period. The outcome of the negotiations would determine the relationship on all matters (including trade), between the two countries from 1st January 2021.

What is meant by "Trade and Co-operation Agreement"?

Trade Agreements are common instruments which exist between countries and customs territories (such as the EU). They facilitate the movement of certain goods by reducing or even completely removing things such as tariffs and / or quotas between the countries involved.

Co-operation Agreements are broader and less defined. They can cover anything from recognition of each other's approvals or standards, movement of people, citizens' rights, etc.

What is a Customs declaration?

A Customs declaration is the formal notification to the Customs authorities of a country that goods are entering or leaving the territory. It consists of a number of data-sets detailing particulars such as who is the shipper and the consignee, the nature and value of the goods, the reason for the import / export, whether special controls apply, etc.

What are Tariffs and Quotas?

Tariffs are import taxes (such as Customs duties) that are applied to goods when they arrive and clear Customs in the destination country. Tariffs are almost always paid as a percentage of the value of the goods.

Quotas are limits on the amount of a certain commodity which can be imported from overseas in any set period (such as over the course of a month).

Tariffs and quotas are generally designed to protect the production markets of the importing country and promote domestic manufacture, discouraging the purchase of the same goods from overseas.

What does the Trade and Co-operation Agreement mean for UK and EU trade?

Goods moving between EU member states have "Community Status", meaning they can travel freely without tariffs, quotas or Customs declarations being required when they cross EU national borders.

Goods that travel into the EU from third (non-EU) countries do require Customs declarations, and are potentially subject to tariffs and quotas. Whether tariffs are payable depends on whether that third country holds a Trade Agreement with the EU.

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When the UK left the EU, it became a third party, and as such would be subject to these trade barriers at the end of the transition period on 1st January 2021, had the Trade Agreement not been reached.

As it is, the EU-UK Trade Agreement now allows free trade between the EU and UK without tariffs or quotas.

Will all goods travelling between the UK and EU still require a Customs declaration?

Yes, if they are commercial goods. There are exemptions for personal effects and different arrangements for goods travelling between Great Britain and Northern Ireland (not covered in this document).

Will all goods between the UK and EU be tariff free?

Not necessarily. Only goods deemed to be "Originating" are eligible for tariff preference when imported to each other's territories.

What does "Originating" mean?

"Originating" means that the goods qualify as originating from either the UK or the EU. This is called Originating Status.

Why does Originating Status matter?

The rules governing originating status (Rules of Origin) prevent goods from being imported by companies in either party and potentially by-passing existing tariff and quotas of the other party that would have applied had they imported goods directly to that party. It prevents either party as being used as a "back-door" to the rest of the world.

How do goods qualify as Originating?

Either by being or consisting of materials which have entirely originated in the either of the parties, or for goods which contain non-originating materials, by acquiring originating status.

How do goods which contain Non-originating materials acquire originating status?

By meeting the Product Specific Rules of Origin.

If goods are imported from a country and assembled into another product, would they qualify as Originating?

Yes, if their identity changed enough to satisfy the Product Specific Rules of Origin. The further removed from the imported HS Customs code that the end-product is, the more likely it is to qualify as originating on re-export.

If goods are imported and do not change their identity between the import and export HS codes, could it still acquire Originating Status?

Only under very certain circumstances. The goods would need to be subjected to some form of operation. Furthermore, this cannot be a "simple" operation, such as just affixing logos, repackaging, diluting with water, etc. These are referred to as "Insufficient Production" operations, and do not qualify for acquiring originating status. Qualifying operations must require specialist skills and

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specialist machinery, apparatus or equipment, especially produced or installed and necessary to perform those operations.

Whose responsibility is it to determine whether goods qualify as Originating and can therefore claim tariff preference?

The exporter of the goods to the other party must understand their product and decide whether they have originating status. If they do, the exporter must make a declaration called a Statement on Origin and provide it to the importer in order for them to claim the tariff preference.

Whose responsibility is the accuracy of the Customs declaration which claims the tariff preference?

The importer making the import declaration. They must be able to demonstrate that they have obtained the Statement on Origin prior to the goods being declared to Customs (if it is not possible to obtain this, they can use another method called “Importer’s Knowledge” which requires a different set of documentary evidence to be held).

Will any of the documentation be subject to Customs audit?

Yes. For this reason, all Bills of Materials, Supplier Declaration forms and decision flow records must be kept on file as evidence to support the use of tariff preference.

Might the evidence used to claim the tariff preference be required by the importing Customs authority at the time of import?

Yes. For this this reason, it should be kept easily accessible to prevent goods being delayed in Customs.

How long must an importer keep a Statement on Origin supplied by the exporter (or if Importer’s Knowledge was used to claim tariff preference, the supporting documentary evidence)?

3 years after the date of importation.

How long must an exporter keep a Statement of Origin which they have supplied to an importer, and the supporting evidence to verify its compliant use?

4 years after the date of completion.

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8.0 Sources

EU-UK Trade and Co-operation Agreement Summary Explainer
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/948093/TCA_SUMMARY_PDF.pdf

EU-UK Trade and Co-operation Agreement
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/948119/EU-UK_Trade_and_Cooperation_Agreement_24.12.2020.pdf

Supplier's Declaration: https://www.gov.uk/guidance/using-a-suppliers-declaration-to-support-a-proof-of-origin

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9.0 Contacts

For further information on how the EU-UK Trade and Co-operation Agreement is likely to impact on your corporate profile, or for assistance on how to best modify your supply chains and shipping processes going forward, please contact us as follows:

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