

# **A Guide to Determining the Origin of Goods Under TAFTA using the “Change in Tariff Classification Method”**

**July 2004**

## **(1) WHAT IS THE PURPOSE OF RULES OF ORIGIN?**

We need rules of origin to provide objective criteria for determining whether or not goods are eligible for the benefit of preferential rates of duty that are provided under the Thailand-Australia Free Trade Agreement (TAFTA).

Sometimes it is obvious that a product originates in a particular country. For instance, if paper is made entirely in Thailand from Thai trees, the paper obviously originates in Thailand. However, if envelopes are folded in Thailand from paper made in Brazil, which one is the country of origin? The FTA rules of origin provide precise answers to such questions.

TAFTA's rules of origin provide precise answers to such questions where products made wholly or fabricated partly in either Australia or Thailand are concerned.

## **(2) HOW DO GOODS QUALIFY AS ORIGINATING?**

A good is considered to be an originating good, if it meets one of the following requirements, as set out in TAFTA's rules of origin:

- the good is wholly obtained or produced in the territory of one of the parties to the Agreement (including those goods that are entirely grown, fished, or mined – it does not include goods purchased in the territory of one of the parties to the Agreement that were imported from the territory of a country not party to TAFTA);
- the good meets the requirements of a specific rule of origin for that product, as listed in the TAFTA Annex; or
- the good meets other requirements as specified in TAFTA.

Of these requirements, the most common is the second, which applies to a good that includes any non-originating materials in its production.

## **(3) WHAT ARE NON-ORIGINATING MATERIALS?**

The non-originating materials used to produce the good are those materials or components that would not qualify as originating under TAFTA's rules of origin.

Non-originating materials are:

- materials or components imported from a country that is not a signatory to TAFTA; or
- materials produced in the TAFTA region but, because of the high level of offshore input used to produce them, do not meet the rule of origin.

**Note**

Any material of unknown or unconfirmed origin should be treated as a non-originating material.

**(4) HOW DO THE SPECIFIC RULES OF ORIGIN WORK?**

TAFTA provides a specific rule of origin for every type of good that incorporates non-originating materials.

Generally, a good qualifies as originating in the TAFTA region if its final production process was undertaken within the TAFTA region, and if the production process resulted in a significant change in all of the components or materials non-originating in either Australia or Thailand. To test whether a significant change has occurred, a tariff classification change test is used.

When a product is transformed from a collection of materials and components into the finished good, there is usually a resulting change from the tariff classifications of the materials and components to that of the finished good.

**(5) HARMONIZED SYSTEM OF TARIFF CLASSIFICATION**

A good's specific rule of origin is based on its tariff classification under the internationally accepted Harmonized System (HS). The HS organizes products according to the degree of production, and assigns them numbers known as classifications. The HS is arranged into 97 chapters covering all products. Each chapter is divided into headings, headings can be divided into subheadings.

Under the Harmonized System, the chapter, heading, and subheading numbers for any good are identical in any country using the HS. However, each country can further divide HS classifications for their own purposes. In Australia, subheadings can be further divided into tariff classifications for imported goods, and Australian Harmonized Export Commodity Codes (AHECC) for exported goods.

## **Example**

Chapter 62 .....	Articles of apparel and clothing accessories, not knitted or crocheted
Heading 6209.....	Babies' garments and clothing accessories
Subheading 6209.10.....	Of wool or fine animal hair
Tariff classification 6209.10.20.....	Clothing accessories

As shown above, headings are identified with a four-digit number, subheadings with a six-digit number, and tariff classifications with an eight-digit number. Subheadings give a more specific description than headings, and tariff classifications give a more specific description than subheadings.

The specific rules of origin in the TAFTA Annex are organized using the HS classification numbers. Therefore, importers determine the HS classification of the imported good and use that classification to find the specific rule of origin in the Annex that applies. If the good meets the requirements of the rule of origin, it is an originating good.

### **(6) HS CLASSIFICATION CHANGE**

Most of the specific rules of origin require a certain HS classification change from the non-originating materials to the finished good. This change must be a result of production in one or other of the parties to TAFTA.

In most cases, the only requirement of a rule of origin will be a HS classification change specified in the TAFTA Annex. Therefore, to determine whether a good qualifies as an originating good under TAFTA, after looking up the specific rule of origin, exporters or producers will need to know only the HS classification of the good, and the HS classification of any non-originating materials.

### **(7) REGIONAL VALUE CONTENT TEST**

For a minority of goods, a specific rule of origin will require the good to meet an additional requirement to qualify as originating. Usually, this additional requirement tests the good's regional value content (RVC), which requires that a certain percentage of the good's value originates in an FTA country.

TAFTA uses a variation of the Build-Down method to calculate the RVC.

Some rules may specify that a good must have at least a 35% RVC. To qualify for originating status under the FTA, therefore, importers have to demonstrate that at least 35% of the good's value originated in the territory of the other party.

If a rule requires an HS classification change and an RVC test, the good has to meet both of these requirements to be an originating good.

**(8) CALCULATING REGIONAL VALUE CONTENT**

Unless specified in the rule, exporters or producers can choose the RVC method to be used.

**Build-Down Method**

$$\text{RVC} = \frac{\text{AV} - \text{VNM}}{\text{AV}} \times 100$$

where

- RVC is the regional value content, expressed as a percentage;
- AV is the adjusted value (value for customs purposes), and
- VNM is the value of non-originating materials that are imported either by the producer of the good or by an Australian or Thai producer of materials supplied to the producer of the good. For most textiles, clothing and footwear products, the value of non-originating materials produced in developing countries, other than Thailand, can be deducted from the VNM, up to a maximum of 25% of the AV.

**Example of Build-Down Method**

A producer sells a good for \$100 in an arm's-length sale. The value of relevant non-originating materials used in the good is \$30. Using the Build-Down method, the producer calculates the RVC as follows

$$\frac{\text{adjusted value} - \text{value of relevant non-originating materials}}{\text{adjusted value}} \times 100 = \text{RVC}$$

$$\frac{\$100 - \$30}{\$100} \times 100 = 70\%$$

Therefore, using the Build-Down value method, the RVC of the good is 70%

**(9) PROCESS RULES**

For some goods, a specific rule of origin will require a particular process to be performed in the territory of one or both of the FTA partners. In these cases, provided that process is performed in the territory of one or both of the FTA partners at some point in the production of the goods, the goods will be originating goods. Unless otherwise specified, no change in classification or RVC requirement needs to be met.

## **Example of Process Rules**

A good classified in Chapter 28 is produced in Australia through a chemical reaction between two materials, A and B, which are both non-originating materials imported from outside the TAFTA region. A Chapter rule for Chapter 28 requires a chemical reaction to take place in the territory of one or both Parties. As the good was produced in Australia through a chemical reaction, the good is an originating good. While alternative rules would also apply to the good, those rules can be disregarded, as the good meets the chemical reaction rule.

### **(10) SPECIAL OPTIONS**

These are additional rules of origin that exporters or producers can use if their goods fail to qualify under the specific rules of origin.

#### **General goods *De minimis* exception to HS classification change requirement**

TAFTA provides relief when a good does not qualify as an originating good only because some non-originating materials of little value fail to meet an HS classification change requirement. If the total value of the non-originating materials in question is no more than 10% of the value of the good, then the exporter or producer can consider the good to be an originating good.

### **Example**

A good uses two materials, A and B, and both are non-originating materials. As a result of its transformation into the finished good, A makes the required HS classification change, but B does not. Because B does not make the required change, the finished good will not qualify unless the value of B is no more than 10% of the good's value. The good is valued at \$100 and the value of B is \$5. The value of B is 5% of the good's value, therefore the goods are considered originating.

The test only considers whether the total value of all non-originating materials that do not meet the HS classification change is less than 10% of the total value of the good.

#### **Accumulation qualification for the HS classification change requirement**

A good may be produced partly in the territory of one TAFTA partner, and completed in the territory of the other TAFTA partner. A good may be made from materials produced by one producer from components produced by another producer. To determine whether a good meets an HS classification change, treat all the production done in both countries as if it occurred in one, and treat the production

done by all producers in the TAFTA region as if it were completed by one.

### **Example**

A producer imports uncoated kraft paper of heading 4804 to make kraft paper lightly coated with plastics of subheading 4811.59. The specific rule of origin for goods of subheading 4811.59 allows a change from any other heading except from heading 4804. The imported uncoated kraft paper is non-originating and was classified in heading 4804. Therefore, the kraft paper lightly coated with plastics is non-originating.

The non-originating kraft paper lightly coated with plastics of subheading 4811.59 is then forwarded to another producer within the TAFTA region. That producer coats the goods with another plastic material, producing kraft paper heavily coated with plastics of subheading 4811.51. The specific rule for that subheading is a change from any other heading. As the change from 4811.59 to 4811.51 is not a change in heading, the goods would normally be non-originating.

However the producer of the kraft paper heavily coated with plastics can accumulate the production of the kraft paper lightly coated with plastics from uncoated kraft paper, because that process also occurred within the TAFTA region. The change in classification becomes a change from uncoated kraft paper of 4804 to kraft paper heavily coated in plastics of subheading 4811.51. As this is a change in heading, the goods meet the specific rule for 4811.51. The kraft paper heavily coated in plastics is therefore originating.

### **(11) CERTIFICATE OF ORIGIN OR OTHER EVIDENCE OF ORIGIN**

There is a Certificate of Origin requirement under TAFTA. All exporters of goods under the Agreement, together with their suppliers, must obtain sufficient evidence that the goods meet the rules of origin. The exporter must then register the goods as originating before obtaining a Certificate of Origin from an authorized body (the Australian Chamber of Commerce and Industry, or the Australian Industry Group).

#### **Where to go for help with rules of origin**

Customs authorities in Australia and Thailand will provide Tariff advice on the goods to be imported. Advice from these authorities is the most reliable for the purposes of TAFTA. Tariff advice can also be obtained from the Customs authority in the exporting country where this is more convenient (for example, where local producers of materials require classification advice).

The Australian Customs Service will also provide advice on the rules of origin for all goods to be imported into its territory. Thailand is not in a position to provide such advice. Rules of origin advice on goods to be exported to Thailand must be obtained from an authorized Certification body.

### ***STEP-BY-STEP GUIDE TO DETERMINING A GOOD'S ORIGIN***

Follow these steps to determine whether a good of mixed origin qualifies as an originating good under TAFTA's rules of origin.

#### **Step 1**

Was the good last processed in the TAFTA region?

If *yes*, go to step 2.

If *no*, the good does not qualify.

#### **Step 2**

Do any of the materials or components used in the good come from outside the territory of the parties to TAFTA, or otherwise do not qualify as originating materials under TAFTA's rules of origin?

If *yes*, go to step 3. (If you do not know the origin of any material, you have to assume it does not originate in a TAFTA country.)

If *no*, the good qualifies.

#### **Step 3**

Determine the HS classification number of the good. The six-digit subheading level is sufficient.

#### **Step 4**

Using the HS classification number, identify the specific rule or rules of origin in the TAFTA Annex that apply to the good.

If two rules apply, the good must meet one of them. One rule may require only an HS classification change, whereas the other requires an easier HS classification change and an RVC test. Select the rule that is most appropriate for the non-originating materials used to produce the goods.

#### **Step 5**

Determine the HS classification of the non-originating materials or components used to produce the good in the TAFTA country.

#### **Step 6**

Does the change from the HS classification of the non-originating materials to the HS classification of the good imported into Australia

meet the HS classification change required in the specific rule or rules of origin identified in Step 4?

If *yes*, the HS classification change requirement is met. Go to Step 7.

If *no*, the good does not qualify (unless it falls under certain exemptions such as the *de minimis* exemption or the accumulation provision, in which case, go to Step 7).

### **Step 7**

Does the specific rule also contain an RVC test?

If *yes*, go to Step 8.

If *no*, and the HS classification change requirement is met, the good qualifies as an originating good. Go to step 9.

### **Step 8 – Build-down value method**

Determine the actual price paid for the good. Determine the CIF value of all non-originating materials imported into Australia or Thailand and used to produce the finished good, or used to produce a non-originating material in Thailand or Australia that was supplied to the producer of the finished product. Using the build-down value formula, calculate the RVC percentage.

If the RVC percentage is equal to or more than the minimum percentage set out in the specific rule of origin, the good qualifies as an originating good, as long as you meet all other requirements of the rule. Go to step 9.

If the percentage is less than the set minimum, the good does not qualify.

### **Step 9**

Determine whether the goods meet any other applicable requirements.

If *yes*, go to step 10.

If *no*, the good does not qualify.

### **Step 10**

If exporting to Thailand, ensure sufficient evidence has been obtained before applying for registration of the goods as originating goods or for a Certificate of Origin. Provide the Certificate of Origin to the importer. The importer must possess a valid Certificate of Origin to claim preferential duty rates.