



A Guide to determining the origin of goods using the “change in tariff classification method”

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 Free Trade Agreement (FTA).

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

This paper contains a reference to an “FTA Region” and to “Regional value Content”. The “Region” referred to means the combined territories of both Parties to the FTA. It does not extend to the territory of either parties’ other FTA partners, that is, it does not cover New Zealand in the case of Australia, or Mexico and Canada in the case of the United States.

July 2004

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 the FTA rules of origin:

- the good is wholly obtained or produced in the territory of one of the parties to the FTA (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 FTA that were imported from the territory of a non-FTA country);
- the good is made up entirely of components and materials that qualify in their own right as goods that originate in the FTA region;
- the good meets the requirements of a specific rule of origin for that product, as listed in the FTA Annex; or
- the good meets other requirements as specified in the FTA

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

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 the FTA rules of origin.

Non-originating materials are:

- materials or components imported from a country that is not a signatory to the FTA; or
- materials produced in an FTA 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.

How do the specific rules of origin work?

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

Generally, a good qualifies as originating in the FTA region if its final production process was undertaken within the FTA region, and if the production process resulted in a significant change in all of the components or materials non-originating in either FTA country. 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.

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 tariff classifications. The HS is arranged into 97 chapters covering all products. Each chapter is divided into headings, headings can be divided into subheadings, subheadings are divided into tariff classifications.

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.

Under the Harmonized System, the chapter, heading, and subheading numbers for any good are identical in any country using the HS. However, the final two digits of the tariff classification are not harmonized – each importing country individually assigns them.

The specific rules of origin in the FTA 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.

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 more of the FTA countries.

Example

Orange marmalade is classified under heading 2007. Fresh oranges are classified under heading 0805. The specific rule of origin for orange marmalade requires a chapter change. If fresh oranges from Brazil are transformed into orange marmalade in Australia, the orange marmalade is an originating good, because a change from chapter 08 to chapter 20 has occurred.

In most cases, the only requirement of a rule of origin will be a HS classification change specified by the FTA Annex. Therefore, to determine whether a good qualifies as an originating good under the FTA, 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.

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.

For example, some rules may specify that a good must have at least a 35% RVC based on the build-up method. 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 as determined using the build-up method.

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.

Calculating regional value content

AUSFTA uses the Build Down method, the Build Up method and the Net Cost method to calculate the regional value content.

Note: the net cost method is used for most automotive goods only. A separate guide will be produced detailing the automotive rules under AUSFTA.

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

Build-down Method

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

where

VC is the regional value content, expressed as a percentage;
AV is the adjusted value (the value for customs purposes), and
VNM is the value of non-originating materials that are acquired and used by the producer in the production of the good. VNM does not include the value of a material that is self-produced.

Example of build-down method

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

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

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

Therefore, using the build-down value method, the RVC of the good is 70%

Build-up Method

$$\text{RVC} = \frac{\text{VOM}}{\text{AV}} \times 100$$

where

RVC is the regional value content, expressed as a percentage;
AV is the adjusted value (the value for customs purposes); and
VOM is the value of originating materials that are acquired or self-produced, and used by the producer in the production of the good.

Example of build-up method

A producer sells a good for \$100 in an arm's-length sale. The value of the originating materials used in the good is \$60. Using the build-up method, the producer calculates the RVC as follows

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

$$\frac{\$60}{\$100} \times 100 = 60\%$$

Therefore, using the build-up value method, the RVC of the good is 60%.

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

The FTA provides relief when a good does not qualify as an originating good only because some non-originating material of little value fails to meet an HS

classification change requirement. If the value of the non-originating material 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 is considered originating.

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

In some cases the *de minimis* exception to the HS classification change requirement cannot be used. Contact Customs to determine whether or not the *de minimis* exception can be used.

***Textile and apparel goods De minimis* exception to HS classification change requirement**

AUSFTA provides relief when a textile or apparel good does not qualify as an originating good only because some non-originating material of little weight fails to meet an HS classification change requirement. If the weight of the non-originating material in question is no more than 7% of the total weight 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 weight of B is no more than 7% of the good's total weight. The good weighs at 200 grams and the weight of B is 10 grams. The weight of B is 5% of the good's weight, therefore the goods is considered originating.

The test only considers whether the total non-originating material that does not meet the HS classification change is less than 7% of the total weight of the finished good.

In some cases the *de minimis* exception to the HS classification change requirement cannot be used. Contact Customs to determine whether or not the *de minimis* exception can be used.

Note: The 10% by value *de minimis* exception applies only to general goods, and the 7% by weight *de minimis* exception applies only to textile and apparel goods.

Accumulation

A good may be produced partly in the territory of one FTA partner, and completed in the territory of the other FTA 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 FTA region as if it were completed by one.

Example

A producer imports non-originating carded cotton, of heading 5203 for use in the production of cotton yarn of heading 5205. Because the change from carded cotton to cotton yarn is a change within the same chapter, the cotton does not satisfy the applicable rule of origin. Therefore, the cotton yarn is also classed as non-originating.

The cotton yarn is then sold to another producer within the territory of the FTA parties, who uses the cotton yarn in the production of woven fabric of heading 5208. The change from cotton yarn to woven fabric does not satisfy the applicable rule of origin. Therefore, the woven fabric is also classed as non-originating.

However the producer of the woven fabric can accumulate the production of the cotton yarn, the cotton yarn would then be considered to have been produced by the producer of the woven fabric. This is allowed because both the yarn and the fabric were both produced within the territory of the FTA parties.

Therefore the change from carded cotton of heading 5203 to woven fabric of 5208 would satisfy the applicable change of tariff classification for heading 5208. The woven fabric of cotton would be considered as an originating good.

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 the FTA rules of origin.

Step 1

Was the good last processed in the FTA 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 the FTA, or otherwise do not qualify as originating materials under the FTA 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 an FTA country.)

If *no*, the good qualifies.

Step 3

Determine the HS classification number of the good being imported into Australia. Usually, the six-digit subheading level is sufficient.

Step 4

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

If two rules apply, you must meet one of them. One rule may require only an HS classification change, whereas the other requires an 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 you use to produce the good in the FTA 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.

Step 7

Does the specific rule also contain an RVC test?

If *yes*, choose whether to use the build-down or build-up method.

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

Step 8(a) – Build-down value method

Determine the actual price paid for the good and the value of the non-originating materials used to produce it. 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 for build-down value calculations, the good qualifies as an originating good, as long as you meet all other requirements of the rule.

If the percentage is less than the set minimum, try using the build-up method.

Step 8(b) – Build-up method

Determine the actual price paid for the good and the value of the originating materials used to produce it. Using the build-up 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 for build-up calculations, the good qualifies as an originating good, as long as the good meets all other requirements of the rule.

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 under the AUSFTA, provide sufficient evidence to the importer that the goods meet the rules of origin. If importing under the AUSFTA, obtain sufficient evidence from the exporter that the goods meet the rules of origin.