



# Rules of Origin - what you need to know

## DLA PIPER TRADE TRUTHS

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With less than two months before the end of the Brexit Transition Period, importers and exporters of goods between the UK and both the EU, and the rest of the world, are preparing for the impact of significant changes to UK and EU trading arrangements upon their businesses and operations. Recent articles in the DLA Piper Trade Truths series have examined the realities of trading on so-called 'World Trade Organisation (WTO) terms', should there be no deal at the end of the Transition Period, including the impact on customs procedures and tariffs on goods, together with the UK's post-Brexit trading landscape.

Last week's edition of Trade Truths explored the UK's post-Brexit international trade landscape, focusing on the various bilateral Free Trade Agreements (FTA) that the UK is negotiating to take effect after the UK's exit from the EU trading bloc, resulting in the UK and EU trade policies diverging for the first time in over 40 years. This week, we focus on Rules of Origin (ROO), a key aspect of the negotiations and fundamental to the functioning of all FTAs. ROOs matter to businesses as an important consideration in structuring efficient international supply chains to take best advantage of the zero tariff rates that they can offer. They should also be considered as potential barriers to trade for market entrants as they can limit competition to the benefit of incumbent producers who take advantage of these ROO.

### What are Rules of Origin?

In simple terms, ROO are the rules by which it is determined where a particular good comes from or where it is made. They are used to enable importers, exporters and regulatory authorities to determine whether the importer of that good is able to take advantage of a reduced or zero tariff rate applicable to the import of that good if it "originates" from one signatory country to the FTA, and is imported into the other.

There are no standard ROO across international trade. Rather, they are particular to each FTA and are negotiated in a bespoke manner, reflecting the objectives of the parties to that agreement. There are broadly two types of ROO:

- "non-preferential rules of origin", which apply to trade under WTO rules where there is no preferential trade arrangement or an alternative regime; and
- "preferential rules of origin", which apply to countries which have a preferential trade arrangement in place such as an FTA.

Where an FTA is in place with agreed ROO, these will be in the form of preferential ROO, and means that certain goods, once their origin has been determined, may be given preferential tariff treatment. Clearly this is important to ensure that goods imported into a country which "originate" in another country with which the country of import has no FTA, do not enjoy those same reduced or zero tariff rates.

### Preferential ROO through EU Membership

Currently, by virtue of the UK's membership to the EU, the UK benefits from preferential ROO with other EU member states and with countries the EU has FTAs with. Once the origin of a good has been determined, businesses need to check whether they qualify for preferential treatment. This can be checked on the UK government website (found here) where businesses can check their customs classification and, therefore, if the goods qualify for a preference scheme.

Ultimately, any preferential rate of duty will depend on there being preferential coverage for goods of that type either between the UK and EU or between the EU and a third country - and the product:

- meets its relevant rule of origin;
- is wholly produced in the preference country or substantially manufactured there according to particular rules; and
- is not subject to a quota which would limit the quantity of the product that can be brought in under the preference.

Where preferential ROO exist, such goods will be subject to a reduced or zero tariff rate.

## Non-Preferential (WTO) ROO

In the absence of an FTA, non-preferential rules of origin would apply. If the UK is unable to conclude negotiations with the EU on an FTA before the end of the Transition Period, non-preferential ROO will apply to UK-EU trade. The UK government has also stated that where there is no FTA between the UK and another nation post-Brexit, the WTO's non-preferential ROO will apply. The WTO established an Agreement on Rules of Origin, which aims, through the Committee on Rules of Origin and the "harmonisation work programme", to harmonise rules of origin and ensure such rules do not themselves create unnecessary obstacles to trade.

Such ROO must be applied on the principle of most-favoured nation (MFN) i.e. in the absence of an FTA between two or more WTO members, countries cannot discriminate between their trading partners. The Agreement on Rules of Origin requires WTO members to administer ROO in a consistent, uniform, impartial and transparent manner, unless they have agreed an FTA with specific countries. However, negotiations on harmonised non-preferential ROO are still not agreed in the WTO and non-preferential rules of origin are not applied by all WTO members, nor are ROO harmonised. Over 40 WTO members currently apply non-preferential rules of origin (which must still be applied on MFN terms). This includes the EU (and the UK, as part of the EU and during the Transition Period). For an in depth explanation of the MFN principle, please see our article on the WTO (found here).

## Determining Rules of Origin

The origin of a good is not determined by the most recent country from which it is imported. Rather, given the reality of complex and multi-jurisdictional supply chains where manufactured goods are assembled from natural resources, components and sub-assemblies produced in numerous countries, the ROO revolve around the "economic nationality" of the relevant good. In essence, this is a question of where value was added to the good.

For less complex goods such as natural resources, the country of origin is usually the country where they were extracted. However, more complex goods assembled from multiple components, such as cars or aeroplanes, are more difficult to determine in this way. For these goods, the ROO are determined by the country of their "last substantial transformation". This is, typically, determined according to a combination of:

- whether goods were transformed in a particular country from one commodity code classification to another due to the extent of further work to essentially produce a new good;
- contribution of a stipulated proportion of the value of the finished good via work or transformation in a particular country - usually 50% or more of the value; and
- "specific processing", i.e. where the ROO specify particular processing activities or types of transformation of goods which must take place for them to be considered as originating in that country.

## Impacts of Brexit on ROO for importers

The UK Government has stated repeatedly that it will not extend the Transition Period ending on 31 December 2020, and the deadline in the Withdrawal Agreement for such an extension has passed. Therefore, irrespective of whether an FTA between the EU-27 and the UK is agreed, substantial changes to the UK's international trading arrangements will take effect from 1 January 2021.

This will include changes to the current ROO applied to the imports/export of goods which apply by virtue of the UK's membership to the EU. In particular the notable changes will be:

- EU imports/exports – ROO will be governed under an EU-UK FTA with its own bespoke preferential ROO or non-preferential ROO under WTO terms.
- Imports/exports between the UK and the rest of the world – ROO will be governed either by non-preferential ROO under WTO terms; or as agreed in the new or replacement bilateral FTAs concluded by the UK as a newly independent international trade actor.

The most significant likely changes to ROO will impact importers from the EU into the UK and vice versa. Currently, goods originating, or with processing or assembly work undertaken in any of the formerly 28 EU member states, all contributed to the consideration of a good imported between the UK and EU as originating in the EU. This meant that significant volumes of goods qualified as EU-origin goods and have therefore been subject to reduced or zero import duties under existing ROO arrangements for transfers of goods within the EU Single Market.

Clearly, after the end of the Transition Period, significant assembly or processing work or transformation in the EU-27 before further work is carried out in the UK, may no longer contribute to the assessment of value added or level of transformation effected on those goods in the UK before their import into another country. Put simply, post-Brexit, what was once all European input/value-added will now have to be separated into UK and EU inputs/value-added. As a result, UK manufacturers or businesses involved in assembly or processing of part finished goods, will struggle to meet any requirements under new FTAs with other countries, including the EU, that goods have potentially 50% or more of their value added in the UK prior to their export. This will make it more difficult to reach the thresholds required under some ROO with the effect that the ability of international businesses to make use of the preferential tariff rates under the UK's FTAs may be significantly reduced.

In addition, at present, ROO checks are not required for goods at customs borders covered by the EU Customs Union. However, from the beginning of next year, it will be necessary for UK exporters to establish that their products comply with ROO. This will mean additional documentation and administrative burdens placed on exporters.

EU and UK negotiators met for three days of talks last week and it is rumoured that both sides could meet for "submarine" talks running until the supposed 15 October deadline date. Currently, there is no evidence to suggest that the UK and EU have agreed any preferential ROO, or any ROO relating to specific goods or categories of goods. The UK's position has long been that it will not remain in the customs union and as a result, whatever is agreed with the EU, assembly or processing work or transformation in the EU-27 is unlikely to contribute to the assessment of value added or level of transformation effected on goods exported from the UK. This will undoubtedly have an impact on most goods affected by ROO provisions, the cost of which will vary depending on a number of factors including the good's commodity code classification; and the proportion of EU inputs/value-added involved in its production.

## What should you be doing?

With less than 90 days to go until the end of the Transition Period, here are some practical steps that you can take to prepare your business for Brexit:

- create Brexit-contingency plans to prepare your business to trade on WTO terms at the beginning of next year;
- start conducting focused supply chain risk assessments to analyse the tariff and non-tariff barriers in your current and future key markets, including rules of origin, regulatory approvals, and customs procedures;
- manage the costs and consequences of regulatory divergence by identifying risks early and building strong relationships in the UK, EU and with the rest of the world, with both decision makers and the business community to ensure that your business and commercial environment remains stable;
- engage with key decision-makers in the UK and EU on issues such as anti-dumping, safeguarding, trade remedies and dispute settlement to better protect yourself in the event your commercial interests are undermined.

## How we can help you

DLA Piper's team of lawyers and government affairs professionals in London and Brussels are here to assist you in your future preparations.

Our market-leading Brexit practice has a strong track record of helping clients prepare. We can carry out audits of your contractual agreements to assess their exposure to Brexit and undertake legal, commercial and human resources impact assessments, to identify areas requiring action.

With our full service, global capabilities, we can help you implement flexible Brexit-contingency plans, so that necessary adjustments can be made easily if a deal is reached before the end of the year.

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### Coming up next in the DLA Piper Trade Truths series

State aid rules have been a key sticking point throughout the UK-EU negotiations in their role as a vehicle for change in the UK Government's approach to domestic spending. We explain the current framework for subsidies, where EU and UK negotiators have set up camp, and what each position might mean for state-level support from 1 January 2021. In a post-COVID economy and as the global trade structures shift and settle, understanding the impact of state aid provisions will be increasingly relevant.

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