

CHAPTER 2: RULES OF ORIGIN

Article 2.1: Purpose

1. The Parties recognize that the benefits of this Agreement should inure to the Parties to the Agreement, rather than to non-parties.
2. The Parties further recognize that these rules are complex, and sourcing patterns resulting from their application may not be transparent. Accordingly, the Parties agree, within three years of the entry into force of this Agreement, to complete an analysis of supply chains under the Agreement. Such analysis shall:
 - (a) Reflect a representative cross-section of products across the Harmonized System;
 - (b) Identify the source of all inputs, whether originating or not;
 - (c) For products for which a claim of preference is based on a change in tariff classification, calculate the effective regional value content;
 - (d) Identify the most-favored nation bound rate for each Party, for each product.
3. Where information has been supplied on a confidential basis in connection with the analysis referenced in paragraph (b), the Parties shall maintain the confidentiality of such information.
4. Upon completion of the analysis referenced in paragraph (b), the Parties shall immediately consult to evaluate whether changes in the rules are appropriate in light of the information gathered.

Section A: General Provisions

Article 2.2: Originating Goods

Except as otherwise provided in this Chapter, each Party shall provide that a good is originating if it is:

- (a) wholly obtained or produced entirely in the territory of one or more of the Parties, as defined in Article 2.3 (Wholly Obtained or Produced Goods);
- (b) produced entirely in the territory of one or more of the Parties using non-originating materials provided the good satisfies all applicable requirements of Annex 2 (Product-Specific Rules of Origin);
- (c) produced entirely in the territory of one or more of the Parties exclusively from originating materials; or

- (d) except for a good provided for in Chapter 61 to 63 of the Harmonized System:
 - (i) produced entirely in the territory of one or more of the Parties;
 - (ii) one or more of the non-originating materials provided for as parts under the Harmonized System used in the production of the good cannot satisfy the requirements set out in Annex 2 (Product-Specific Rules of Origin) because both the good and its materials are classified in the same subheading or same heading that is not further subdivided into subheadings or, the good was imported into the territory of a Party in an unassembled or a disassembled form but was classified as an assembled good pursuant to rule 2(a) of the General Rules of Interpretation of the Harmonized System; and
 - (iii) the regional value content of the good, determined in accordance with Article 2.5 (Regional Value Content), is not less than 75 percent if the transaction value method is used; or not less than 65 percent if the net cost method is used;

and the good satisfies all other applicable requirements of this Chapter.

Article 2.3: Wholly Obtained or Produced Goods

Each Party shall provide that, for the purposes of Article 2.2 (Originating Goods), a good is wholly obtained or produced entirely in the territory of one or more of the Parties if it is:

- (a) a mineral good or other naturally occurring substance extracted or taken from there;
- (b) a plant, plant good, vegetable, or fungus, grown, cultivated, harvested, picked, or gathered there;
- (c) a live animal born and raised there;
- (d) a good obtained from a live animal there;
- (e) an animal obtained by hunting, trapping, fishing, gathering, or capturing there;
- (f) a good obtained from aquaculture there;
- (g) fish, shellfish, or other marine life taken from the sea, seabed or subsoil outside the territories of the Parties and, under international law, outside the territorial sea of non-Parties, by vessels that are registered, listed, or recorded with a Party and entitled to fly the flag of that Party;

- (h) a good produced from goods referred to in subparagraph (g) on board a factory ship that is registered, listed, or recorded with a Party and entitled to fly the flag of that Party;
- (i) a good other than fish, shellfish, and other marine life taken by a Party or a person of a Party from the seabed or subsoil outside the territories of the Parties, provided that Party has the right to exploit that seabed or subsoil;
- (j) waste and scrap derived from:
 - (i) production there, or
 - (ii) used goods collected there, provided the goods are fit only for the recovery of raw materials; and
- (k) a good produced there, exclusively from goods referred to in subparagraphs (a) through (j), or from their derivatives, at any stage of production.

Article 2.4: Treatment of Recovered Materials Used in the Production of a Remanufactured Good

1. In furtherance of the mutual goal of minimizing waste and encouraging recycling, each Party shall provide that a recovered material derived in the territory of one or more of the Parties is treated as originating when it is used in the production of, and incorporated into, a remanufactured good.
2. For greater certainty:
 - (a) a remanufactured good is originating only if it satisfies the applicable requirements of Article 2.2 (Originating Goods); and
 - (b) a recovered material that is not used or incorporated in the production of a remanufactured good is originating only if it satisfies the applicable requirements of Article 2.2 (Originating Goods).

Article 2.5: Regional Value Content

1. Except as provided in paragraph 6, each Party shall provide that the regional value content of a good shall be calculated, at the choice of the importer, exporter, or producer of the good, on the basis of either the transaction value method set out in paragraph 2 or the net cost method set out in paragraph 3.
2. Each Party shall provide that an importer, exporter, or producer may calculate the regional value content of a good on the basis of the following transaction value method:

$$RVC = (TV - VNM) / TV \times 100$$

where

RVC is the regional value content, expressed as a percentage;

TV is the transaction value of the good, adjusted to exclude any costs incurred in the international shipment of the good; and

VNM is the value of non-originating materials including materials of undetermined origin used by the producer in the production of the good.

3. Each Party shall provide that an importer, exporter, or producer may calculate the regional value content of a good on the basis of the following net cost method:

$$RVC = (NC - VNM) / NC \times 100$$

where

RVC is the regional value content, expressed as a percentage;

NC is the net cost of the good; and

VNM is the value of non-originating materials including materials of undetermined origin used by the producer in the production of the good.

4. Each Party shall provide that the value of non-originating materials used by the producer in the production of a good shall not, for the purposes of calculating the regional value content of the good under paragraph 2 or 3, include the value of non-originating materials used to produce originating materials that are subsequently used in the production of the good.

5. Each Party shall provide that if a non-originating material is used in the production of a good, the following may be counted as originating content for the purpose of determining whether the good meets a regional value content requirement:

- (a) the value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and
- (b) the value of any originating material used in the production of the non-originating material undertaken in the territory of one or more of the Parties.

6. Each Party shall provide that an importer, exporter, or producer shall calculate the regional value content of a good solely on the basis of the net cost method set out in paragraph 3 if the rule under the Annex 2 (Product-Specific Rules of Origin) does not provide a rule based on the transaction value method.

7. For the purposes of calculating the net cost of a good under paragraph 3, the producer of the good may:

- (a) calculate the total cost incurred with respect to all goods produced by that producer, subtract any sales promotion, marketing, and after-sales service costs, royalties paid to non-affiliated parties, shipping and packing costs, and non-allowable interest costs that are included in the total cost of all those goods, and then reasonably allocate the resulting net cost of those goods to the good;
- (b) calculate the total cost incurred with respect to all goods produced by that producer, reasonably allocate the total cost to the good, and then subtract any sales promotion, marketing, and after-sales service costs, royalties paid to non-affiliated parties, shipping and packing costs, and non-allowable interest costs that are included in the portion of the total cost allocated to the good; or
- (c) reasonably allocate each cost that forms part of the total cost incurred with respect to the good so that the aggregate of these costs does not include any sales promotion, marketing, and after-sales service costs, royalties paid

to non-affiliated parties, shipping and packing costs, and non-allowable interest costs, provided that the allocation of all those costs is consistent with the provisions regarding the reasonable allocation of costs set out in the Uniform Regulations.

Article 2.6: Value of Materials Used in Production

Each Party shall provide that, for the purposes of this Chapter, the value of a material is:

- (a) for a material imported by the producer of the good, the transaction value of the material at the time of importation, including the costs incurred in the international shipment of the material;
- (b) for a material acquired in the territory where the good is produced:
 - (i) the price paid or payable by the producer in the Party where the producer is located,
 - (ii) the value as determined for an imported material in subparagraph (a), or
 - (iii) the earliest ascertainable price paid or payable in the territory of the Party; or
- (c) for a material that is self-produced, all the costs incurred in the production of the material, which includes general expenses.

Article 2.7: Intermediate Materials

Each Party shall provide that any self-produced material that is used in the production of a good may be designated by the producer of the good as an intermediate material for the purpose of calculating the regional value content of the good under paragraph 2 or 3 of Article 2.5 (Regional Value Content), provided that if the intermediate material is subject to a regional value content requirement, no other self-produced material subject to a regional value content requirement used in the production of that intermediate material may itself be designated by the producer as an intermediate material.

Article 2.8: Indirect Materials

An indirect material shall be considered to be an originating material without regard to where it is produced.

Article 2.9: *De Minimis*

1. For a good subject to a regional value content requirement, each Party shall provide that a good is an originating good if the value of all non-originating materials used in the production of the good is not more than 7 percent:

- (a) of the transaction value of the good adjusted to exclude any costs incurred in the international shipment of the good; or
- (b) of the total cost of the good,

provided that the good satisfies all other applicable requirements of this Chapter.

2. For a good subject to a change in tariff classification, each Party shall provide that a good is an originating good if the value of all non-originating materials used in the production of the good is not more than 7 percent:

- (a) of the transaction value of the good adjusted to exclude any costs incurred in the international shipment of the good; or
- (b) of the total cost of the good,

provided that the good satisfies all other applicable requirements of this Chapter.

3. If a good described in paragraph 2 is also subject to a regional value content requirement, the value of those non-originating materials shall be included in the value of non-originating materials for the applicable regional value content requirement.

4. To the extent this Article conflict with Articles 2.14 (Textile and Apparel *De Minimis*) and 2.15 (Treatment of Sets), Articles 2.14 and 2.15 shall prevail.

Article 2.10: Packing Materials and Containers for Shipment

Each Party shall provide that packing materials and containers for shipment are disregarded in determining whether a good is originating.

Article 2.11: Sets of Goods, Kits or Composite Goods

1. Except as provided in Annex 2 (Product-Specific Rules of Origin), each Party shall provide that for a set classified as a result of the application of rule 3 of the General Rules for the Interpretation of the Harmonized System, the set is originating only if each good in the set is originating and both the set and the goods meet the other applicable requirements of this Chapter.
2. Notwithstanding paragraph 1, for a set classified as a result of the application of rule 3 of the General Rules for the Interpretation of the Harmonized System, the set is originating if the value of all the non-originating goods in the set does not exceed five percent of the value of the set.
3. For purposes of paragraph 2, the value of the non-originating goods in the set and the value of the set shall be calculated in the same manner as the value of non-originating materials and the value of the good.
4. To the extent this Article conflict with Articles 2.14 (Textile and Apparel *De Minimis*) and 2.15 (Treatment of Sets), Articles 2.14 and 2.15 shall prevail.

Article 2.12: Transit and Transshipment

Each Party shall provide that if an originating good is transported outside the territories of the Parties, the good retains its originating status if the good

- (a) remains under customs control in the territory of a non-Party; and
- (b) does not undergo an operation outside the territories of the Parties other than unloading, reloading, or storing.

Article 2.13: Non-Qualifying Operations

Each Party shall provide that a good shall not be considered to be an originating good merely by reason of:

- (a) mere dilution with water or another substance that does not materially alter the characteristics of the good; or
- (b) a production or pricing practice in respect of which it may be demonstrated, on the basis of a preponderance of evidence, that the object was to circumvent this Chapter.

Section B: Textiles and Apparel

Article 2.14: Textile and Apparel *De Minimis*

1. A textile or apparel good that is not an originating good because certain fibers or yarns used in the production of the component of the good that determines the tariff classification of the good do not undergo an applicable change in tariff classification set out in Annex 2 (Product-Specific Rules of Origin) shall nonetheless be considered to be an originating good if the total weight of all such fibers or yarns in that component is not more than ten percent of the total weight of that component.
2. Notwithstanding paragraph 1, a good containing elastomeric yarns in the component of the good that determines the tariff classification of the good shall originate only if such yarns are wholly formed in the territory of a Party.⁶

Article 2.15: Treatment of Sets

1. Notwithstanding the product-specific rules of origin set out in Annex 2 (Product-Specific Rules of Origin), textile and apparel goods put up in sets for retail sale, classified as a result of the application of Rule 3 of the General Rules for the Interpretation of the Harmonized System, shall not be originating goods unless each of the goods in the set is an originating good or the total value of the non-originating goods in the set does not exceed 10 percent of the value of the set.
2. For the purposes of paragraph 1:
 - (a) the value of non-originating goods in the set shall be calculated in the same manner as the value of non-originating materials; and
 - (b) the value of the set shall be calculated in the same manner as the value of the good.

Section C: Definitions

For the purposes of this Chapter:

aquaculture means the farming of aquatic organisms, including fish, molluscs, crustaceans, other aquatic invertebrates and aquatic plants from seed stock such as eggs, fry, fingerlings, or larvae, by intervention in the rearing or growth processes to enhance production such as regular stocking, feeding, or protection from predators;

fungible goods or **fungible materials** means goods or materials that are interchangeable for commercial purposes and the properties of which are essentially identical;

good means merchandise, a product, an article, or a material;

indirect material means a material used in the production, testing, or inspection of a good but not physically incorporated into the good, or a material used in the maintenance of buildings or the operation of equipment associated with the production of a good, including:

- (a) fuel and energy;
- (b) tools, dies, and molds;
- (c) spare parts and materials used in the maintenance of equipment and buildings;
- (d) lubricants, greases, compounding materials, and other materials used in production or used to operate equipment and buildings;
- (e) gloves, glasses, footwear, clothing, safety equipment, and supplies;
- (f) equipment, devices, and supplies used for testing or inspecting the goods;
- (g) catalysts and solvents; and
- (h) any other material that is not incorporated into the good but for which the use in the production of the good can reasonably be demonstrated to be a part of that production;

intermediate material means a material that is self-produced and used in the production of a good, and designated pursuant to Article 2.7 (Intermediate Materials);

material means a good that is used in the production of another good, and includes a part or an ingredient;

net cost means total cost minus sales promotion, marketing and after-sales service costs, royalties paid to non-affiliated companies, shipping and packing costs, and non-allowable interest costs that are included in the total cost;

net cost of a good means the net cost that can be reasonably allocated to a good using one of the methods set out in Article 2.5 (Regional Value Content);

non-allowable interest costs means interest costs incurred by a producer that exceed 700 basis points above the applicable federal government interest rate identified in the Uniform Regulations for comparable maturities;

non-originating good or **non-originating material** means a good or material that does not qualify as originating under this Chapter;

originating good or **originating material** means a good or material that qualifies as originating under this Chapter;

packaging materials and containers means materials and containers in which a good is packaged for retail sale;

packing materials and containers means materials and containers that are used to protect a good during transportation;

producer means a person who engages in the production of a good;

production means growing, cultivating, raising, mining, harvesting, fishing, trapping, hunting, capturing, breeding, extracting, manufacturing, processing, or assembling a good, or aquaculture;

reasonably allocate means to apportion in a manner appropriate to the circumstances;

royalties means payments of any kind, including payments under technical assistance or similar agreements, made as consideration for the use or right to use a copyright, literary, artistic, or scientific work, patent, trademark, design, model, plan, or secret formula or process, excluding those payments under technical assistance or similar agreements that can be related to specific services such as:

- (a) personnel training, without regard to where the training is performed; or
- (b) if performed in the territory of one or more of the Parties, engineering, tooling, die- setting, software design and similar computer services, or other services;

sales promotion, marketing, and after-sales service costs means the following costs related to sales promotion, marketing, and after-sales service:

- (a) sales and marketing promotion; media advertising; advertising and market research; promotional and demonstration materials; exhibits; sales conferences, trade shows, and conventions; banners; marketing displays; free samples; sales, marketing, and after-sales service literature (product brochures, catalogs, technical literature, price lists, service manuals, or sales aid information); establishment and protection of logos and trademarks; sponsorships; wholesale and retail restocking charges; or entertainment;
- (b) sales and marketing incentives; consumer, retailer, or wholesaler rebates; or merchandise incentives;
- (c) salaries and wages, sales commissions, bonuses, benefits (for example, medical, insurance, or pension), travelling and living expenses, or membership and professional fees for sales promotion, marketing and after-sales service personnel;
- (d) recruiting and training of sales promotion, marketing, and after-sales service personnel, and after-sales training of customers' employees, if those costs are identified separately for sales promotion, marketing, and after-sales service of goods on the financial statements or cost accounts of the producer;

- (e) product liability insurance;
- (f) office supplies for sales promotion, marketing, and after-sales service of goods, if those costs are identified separately for sales promotion, marketing, and after-sales service of goods on the financial statements or cost accounts of the producer;
- (g) telephone, mail, and other communications, if those costs are identified separately for sales promotion, marketing, and after-sales service of goods on the financial statements or cost accounts of the producer;
- (h) rent and depreciation of sales promotion, marketing, and after-sales service offices, and distribution centers;
- (i) property insurance premiums, taxes, cost of utilities, and repair and maintenance of sales promotion, marketing, and after-sales service offices and distribution centers, if those costs are identified separately for sales promotion, marketing, and after-sales service of goods on the financial statements or cost accounts of the producer; and
- (j) payments by the producer to other persons for warranty repairs;

self-produced material means a material that is produced by the producer of a good and used in the production of that good;

shipping and packing costs means the costs incurred in packing a good for shipment and shipping the good from the point of direct shipment to the buyer, excluding costs of preparing and packaging the good for retail sale;

textile or apparel good means a textile or apparel good classified in HS subheading 4202.12, 4202.22, 4202.32, or 4202.92 (luggage, handbags and similar articles with an outer surface of textile materials), heading 50.04 through 50.07, 51.04 through 51.13, 52.04 through 52.12, 53.03 through 53.11, Chapter 54 through 63, heading 66.01 (umbrellas) or heading 70.19 (yarns and fabrics of glass fiber), subheading 9404.90 (articles of bedding and similar furnishing), or heading 96.19 (babies diapers and other sanitary textile articles);

total cost means all product costs, period costs, and other costs incurred in the territory of one or more of the Parties, where:

- (a) product costs are costs that are associated with the production of a good and include the value of materials, direct labor costs, and direct overheads;
- (b) period costs are costs, other than product costs, that are expensed in the period in which they are incurred, such as selling expenses and general and administrative expenses; and

- (c) other costs are all costs recorded on the books of the producer that are not product costs or period costs, such as interest.

Total cost does not include profits that are earned by the producer, regardless of whether they are retained by the producer or paid out to other persons as dividends, or taxes paid on those profits, including capital gains taxes;

transaction value means the customs value as determined in accordance with the Customs Valuation Agreement, except as otherwise provided in Annex 2;

used means used or consumed in the production of goods; and

value means value of a good or material for purposes of calculating customs duties or for the purposes of applying this Chapter.

Annex 2: Product Specific Rules

[DRAFTING NOTE: Product specific rules are negotiated on the basis of tariff lines of the Harmonized System. For industrial goods, the following principles should guide the negotiations:

- Rules providing for a “change in subheading” are likely to permit significant non-originating content (*i.e.*, from outside the territories of the Parties). Such rules should be exceptional and transition to “change in chapter” over no greater a period than five years. Where the most-favored nation rate is low, and empirical evidence demonstrates that a “change in chapter” will lead a majority of importers to pay the tariff rather than comply with the rules, then a “change in heading” rule may be appropriate.
- To enhance transparency and compliance, most rules should have a regional value content requirement, rather than a change in tariff classification. The RVC should be a minimum of 75%. With the exception of automotive products, where the most-favored nation rate is low, and empirical evidence demonstrates that a “change in chapter” will lead a majority of importers to pay the tariff rather than comply with the rules, then a lower RVC may be appropriate.
- For automotive products, the mechanism for calculating regional value content should be based on the original NAFTA, with a tracing list to ensure that certain products are produced in the region in order for the finished good to benefit from tariff preferences. Steel and aluminum should be included on the tracing list. The “deemed originating” provision of the NAFTA rules should be eliminated. The tracing list should be subject to review, with Congressional oversight, and updated periodically as automotive technology evolves. Therefore, Article 2.5 should be modified in the product specific rules to reflect these requirements. Further, because U.S. production is integrated with Canadian and Mexican production, agreements not including Canada and Mexico should make allowance for sufficient Canadian and Mexican that the rules do not ultimately disadvantage American production, which itself relies on Canadian and Mexican content.
- For textile and apparel goods, the supply chains are complex and domestic producers should be consulted to ensure that the rules maximize American content.
- To mitigate labor, environmental, and tax arbitrage, subject to a phase-in period of 5 years, non-originating content may only come from countries that have agreed to implement Chapters 4, 5, and 6.
- Because trade in goods from non-market economies is inherently distorted, content from such economies should be prohibited after a phase-in of 5 years.]