Client Alert | International Trade

Hard or Soft Brexit – does it matter for the origin of goods?

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The United Kingdom (UK) leaving the European Union (EU) will inevitably result in difficulties for businesses using UK content in their products for export under EU Free Trade Agreements, or for UK businesses using EU content under future UK FTAs.[1]

If or when the UK leaves the EU, it will become a third country. What does this mean for products produced in the EU with UK content: will these products still be able to benefit from tariff preferences when exported to third countries under EU Free Trade Agreements (FTAs)? Will origin certificates, invoice declarations and long-term suppliers' declarations issued before Brexit declaring that a product meets relevant preferential origin rules still be valid after Brexit? Does it matter if Brexit happens with or without a deal (meaning at least a deal for a transitional period)? What about "approved exporter" authorisations and Binding Origin Information?

Preferential rules – the devil is in the detail

In order to benefit from the tariff preferences agreed in FTAs, a product must satisfy preferential origin rules. These rules determine how much of the input materials must be sourced in the FTA area (i.e., in the EU and the FTA partner country) or how much processing must be carried out there. The rationale is that an FTA should normally increase trade between the FTA partners and benefit companies in the FTA area, without giving "undeserved" benefits to other companies and countries (if the FTA fits in a regional integration context, e.g. the Pan-Euro-Med Region, special origin "cumulation" rules will apply, allowing input sourcing throughout that region and a spread of the benefit.)

Product-specific origin rules will typically put a limit on the amount of non-originating materials allowed in a product (e.g., a "value added rule" may limit non-originating content to 40% or 50% of the value of the finished product). Alternatively, the rule may specify what type of processing must be carried out on those materials in the FTA area in order for the finished product to acquire "originating status" (e.g., a chemical reaction must take place in the FTA area). As long as the UK is an EU Member State, UK content in products produced in any EU country will help satisfy the origin rule. However, when the UK becomes a third country, UK content will no longer count in favour of EU origin. Depending on the relative importance of UK content in an EU production process, the EU content could conceivably fall below the required minimum, post-Brexit. FTAs usually do not allow (or only within very strict limits) intermediate processing to be carried out outside the FTA area, so this would mean UK processing after Brexit would jeopardise the final product's EU origin.

1 This alert focuses on the impact for EU businesses, but origin issues for UK businesses will be similar.

Example - The preferential origin rule for passenger cars in EU FTAs often requires that non-originating materials cannot represent more than 40% of the value of the finished car to be exported. If currently 20% of the car's inputs are UK origin, 40% EU27 origin, and the remaining 40% are sourced outside the FTA area, then pre Brexit the origin rule is satisfied (60% originating vs. 40% non-originating content) but not after Brexit (40% originating vs. 60% non-originating content.) Therefore, unless the UK content is replaced by EU or FTA partner content, the car produced in the EU27 will not have EU origin and will not benefit from preferential duty access on export to Japan.

Maintaining EU origin for pre-Brexit products?

EU businesses are rightly questioning whether inventory products with UK content that satisfied the relevant EU origin rule **before** Brexit will keep that status **after** Brexit. Will their customers in EU FTA partner countries still be able to import these products under preferential terms after Brexit if EU content drops below the required minimum (as described above)? Is there a risk of customers seeking damages based on contractual obligations and origin claims made in the past?

If the UK exits the EU **with a deal** that would allow for a transitional period, the EU has promised to ask its FTA partner countries to treat the UK as if it were still an EU Member State, i.e. to treat UK content as originating in the EU, and to consider processing in the UK as equivalent to processing in the EU. However, there is no guarantee that the partner country will grant such flexibility, as, legally, the UK will no longer be an EU Member State covered by the FTA.

In case of a **no-deal** Brexit, the European Commission, on 11 March 2019, issued helpful "preparedness guidance" on "customs related matters in case of no deal" (available *here*) in which it addresses these and other origin-related issues as follows:

- For exports from the EU27 effected or ensured before Brexit, **proofs of origin or origin statements issued before Brexit** (including by the UK) remain valid for the period provided for in the FTA (e.g. 12 months under the EU-Japan FTA, 4 months under the EU-Switzerland FTA).
- If an EU FTA partner country **questions the origin of a product imported from the EU**, the Member State customs authority responding to a request for verification under the FTA's administrative cooperation rules will assess whether the rules of origin applicable at the time the proof was issued were satisfied. For proofs issued before Brexit, this effectively means that UK content would continue to count in favour of EU origin. Likewise, **proofs of origin issued by an EU FTA partner country** for goods containing UK content should remain valid for the period provided for in the FTA if issued before Brexit.
- For proofs of origin issued post-Brexit, UK content will count as non-originating content. This means that UK materials cannot be used in the EU or in the FTA partner country for origin cumulation purposes. (We note that this is the default situation unless and until all countries involved have origin rules in place to allow for such "diagonal" cumulation.)
- For **suppliers' declarations** (issued by suppliers to customers using their inputs for further processing into another product in order to support the customers' claims on the origin of these products), the supplier should inform exporters/traders relying on these declarations of changes to the origin status of goods supplied before Brexit.
- A **long-term supplier's declaration** (a simplification to cover shipments over a longer period of time, to avoid having to issue a supplier's declaration for each consignment) issued before Brexit may no longer be valid after Brexit, e.g., because of the UK content. If so, the supplier must inform the exporter/trader that this is the case for consignments made after Brexit.
- **EU "approved exporters"**[2] (i.e., exporters allowed to issue "invoice declarations" and thus self-declare that a product has preferential origin) which were authorised by the UK authorities (or by an EU27 customs authority but based on a UK EORI[3] number) must, in order to keep that status, be

[2] The same rules will apply for "**registered exporters**" (REX), e.g., under recent or future EU FTAs.

[3] This stands for Economic Operator Registration Identification and an EORI number is required for any business dealing with EU customs authorities.

authorised under an approved exporter authorization issued in the EU27 based on an EORI number issued in the EU27, i.e., they must apply for a new authorisation. In addition, approved exporters have to inform their authorising customs authority of changes in the origin determination resulting from a re-assessment of origin, so that the authorisation can be amended[4] or withdrawn, as appropriate. So, all approved exporters currently using UK content should be re-assessing whether their products will still meet the relevant origin rules after Brexit.

- **Binding Origin Information** (BOI) issued by the UK before Brexit can no longer be relied on after Brexit by companies in the EU27. If such EU27 companies wish legal certainty as to the origin of their product, they will have to seek new BOI, as BOI cannot be amended under EU customs rules.

Conclusion - Do the maths now, prepare for extra paperwork and hope for goodwill from FTA partners

Brexit will mean a re-assessment of whether a product will still meet the relevant preferential origin rules, and whether sourcing inputs need to be changed to continue benefiting from tariff preferences, and potentially to meet contractual obligations.

In case of a Soft Brexit, UK content may under some EU FTAs (depending on the FTA partner country) continue to count in favour of EU origin, but this is not guaranteed. In case of a Hard Brexit, apart from some grandfathering of origin for goods produced in the EU prior to Brexit, UK content may well jeopardize EU origin. Existing UK authorisations and UK BOI cease to be valid in the EU, and new EU27 authorisations and BOI may have to be sought. Going forward, whether the Brexit will be hard or soft, EU and UK FTAs may allow for diagonal cumulation of origin, if all FTA partners agree to this and are prepared to amend the origin rules to this end, which will take time.

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[4] Because approved exporter authorisations often cover more than one FTA, and because the FTAs covered may have different origin rules for the same product, it is possible that the authorisation may still be valid for some destinations, but not others, which would then need to be removed from the list of FTAs under which the exporter can issue invoice declarations.