

Overview of Chapter 4 (Rules of Origin) of the US-Mexico-Canada Trade Agreement

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The US-Mexico-Canada Agreement (USMCA) announced on September 30, 2018 envisions significant changes to the rules of origin established under the North American Free Trade Agreement (NAFTA). The changes contained in the USMCA Chapter on Rules of Origin fall into two general categories:

- Updates to the **general rule of origin principles** found in the NAFTA, incorporating provisions and concepts from more recent trade agreements such as the Trans-Pacific Partnership (TPP); and
- Changes to the **product-specific rules of origin** (e.g., tariff shift and regional value content requirements) for various products, including automotive goods, textiles, chemicals, and steel-intensive goods.

The changes made by the USMCA have the potential to affect manufacturing and supply chains for a wide range of industries, as certain products currently eligible for duty-free treatment under the NAFTA might not qualify under the USMCA rules (or vice-versa). We provide below an overview of the key changes and our perspectives thereon.

General Rules of Origin Principles

The general principles for determining origin under the USMCA are similar to those found in the NAFTA. Under the USMCA, a good will qualify as originating, and will therefore be eligible for preferential tariff treatment, if it satisfies one of the following criteria:

- **The good is wholly obtained or produced entirely in the territory of one or more Parties.** This rule remains largely unchanged from the NAFTA, though the USMCA makes minor updates to the definition of a “wholly obtained or produced” good.¹
- **The good is produced entirely in the territory of one or more of the Parties using non-originating materials, provided the good satisfies the applicable product-specific rules of origin set forth in the Agreement.** The USMCA’s product-specific rules of origin, like those in the NAFTA, are based on changes in tariff classification, regional value content (RVC) requirements, and/or other product-specific processing

¹ For example, the USMCA expressly provides that goods obtained from aquaculture production in the territory of a Party qualify as “wholly obtained or produced” there.

requirements (e.g., the “chemical reaction rule”). RVC must be calculated using either the “net cost”² method or the “transaction value”³ method (the same two methods permitted under the NAFTA). Many of the product-specific rules of origin found in the NAFTA have been revised in the USMCA, as discussed in greater detail below.

- **The good is produced entirely in the territory of one or more of the Parties exclusively from originating materials.** This rule remains unchanged from the NAFTA rule, which held that goods originate if they are produced entirely in Canada, Mexico and/or the United States exclusively from materials that are considered to be originating according to the terms of the Agreement.
- **The good is produced entirely in the territory of one or more of the Parties, is classified with its materials or satisfies the “unassembled goods” requirement, and meets an RVC threshold.** This rule, which is largely unchanged from the NAFTA, provides that a good is originating if:
 - One or more of the non-originating materials used to produce the good cannot satisfy the applicable product-specific rules of origin because both the good and its materials are classified in the same tariff heading (thus precluding a tariff shift); or
 - The good was imported into the territory of a Party in unassembled or disassembled form but was classified as an assembled good pursuant to General Rule of Interpretation 2(a) of the Harmonized System; and
 - The regional value content of the good is at least 60% when calculated using the transaction value method, or at least 50% when using the net cost method.

Updates to General Rules of Origin Provisions

The general principles for determining origin under the USMCA are similar to those found in the NAFTA, but the USMCA makes several important changes drawn from more recent trade agreements such as the TPP. Several of these changes would provide additional flexibility for traders seeking to qualify for preferential tariff treatment, compared to the existing NAFTA rules.

Increased *De Minimis* Thresholds for Non-Originating Content

The USMCA increases to 10% the level of non-originating content that is considered *de minimis* and therefore does not render a good non-originating, even if the good fails to satisfy an applicable tariff change or regional value content requirement. This increase also was included in the TPP, and will provide additional flexibility for traders seeking to qualify for USMCA tariff preferences. The new *de minimis* rules are as follows:

- A good will qualify as originating if the value of all non-originating materials used in its production that do not undergo an applicable change in tariff classification is not more than 10% of the transaction value⁴ or total cost of the good (provided the good satisfies all other applicable origin requirements).⁵ This *de minimis* threshold is currently 7% under the NAFTA.
- A good that is otherwise subject to an RVC requirement will not be required to satisfy that requirement if (1) the value of all non-originating materials used in its production is not more than 10% of the transaction value

² Under the net cost method, RVC is calculated by subtracting the value of non-originating materials from the total net cost to produce the good and dividing this figure by the good's total net cost.

³ Under the transaction value method, RVC is calculated by subtracting the value of non-originating materials from the transaction value of the good and dividing this figure by the good's total transaction value.

⁴ For purposes of this provision, the transaction value is adjusted to exclude any costs incurred in the international shipment of the good.

⁵ If such a good is also subject to an RVC requirement, the value of the *de minimis* non-originating materials must be included in the value of non-originating materials for the applicable RVC requirement.

of the good⁶; or (2) the total cost of the good (provided the good satisfies all other applicable origin requirements). This *de minimis* threshold is currently 7% under the NAFTA.

Like the NAFTA, the USMCA contains a list of products that are ineligible for these *de minimis* exemptions (including many food and agricultural products).

New Provision on Treatment of “Recovered Materials”

A new rule in the USMCA provides that a “recovered material”⁷ derived in the territory of one or more of the parties will qualify as originating when it is used in the production of, and is incorporated into, a “remanufactured good.”⁸ A similar provision was included in the TPP, and was touted as a means of facilitating trade and production of remanufactured goods within the region.

Calculation of Regional Value Content

As noted above, the USMCA provides that RVC may be calculated using the same methods (either net cost or transaction value) permitted under NAFTA. However, a new rule in the USMCA provides that, where a non-originating material is used in the production of a good, the following may be counted as originating content for purposes of calculating RVC under either method:

- The value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and
- 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.

This provision also was included in the TPP, and will provide additional flexibility for traders seeking to satisfy RVC requirements under the USMCA.

Updated Provisions on Accumulation

Like the NAFTA, the USMCA provides for “accumulation” (*i.e.*, products of one Party can be further processed or added to products in another Party as if they had originated in the latter Party). However, the USMCA replaces the NAFTA accumulation rules with updated language that is nearly identical to that found in the TPP. The USMCA accumulation rules are as follows:

- A good is originating if it is produced in the territory of one or more of the Parties by one or more producers, provided that it satisfies all applicable origin requirements;
- An originating good or material of one or more Parties is considered as originating in the territory of another Party when it is used as a material in the production of a good there; and
- Production undertaken on a non-originating material in one or more of the Parties contributes to the originating status of the good, regardless of whether that production was sufficient to confer originating status to the material itself.

⁶ For purposes of this provision, the transaction value is adjusted to exclude any costs incurred in the international shipment of the good.

⁷ A “recovered material” is defined as a material in the form of one or more individual parts that results from: (a) the disassembly of a used good into individual parts; and (b) the cleaning, inspecting, testing or other processing of those parts as necessary for improvement to sound working condition.

⁸ A remanufactured good means a good classified in HS Chapters 84 through 90 or under heading 94.02, except goods classified under HS headings 84.18, 85.09, 85.10, and 85.16, 87.03 or subheadings 8414.51, 8450.11, 8450.12, 8508.11, and 8517.11, that is entirely or partially composed of recovered materials and:

- (a) has a similar life expectancy and performs the same as or similar to such a good when new; and
- (b) has a factory warranty similar to that applicable to such a good when new.

New Provision on Sets, Kits, and Composite Goods

A new rule in the USMCA specifically addresses goods that are imported in sets and are classified as such as a result of the application of rule 3 of the General Rules for the Interpretation of the Harmonized System. The USMCA provides that such sets are originating only if each good in the set is originating and both the set and the goods meet all other applicable requirements of the USMCA rules of origin chapter. However, if the value of all the non-originating goods in the set does not exceed 7% of the set's total value, the set will qualify as originating.⁹ Recent trade agreements such as the KORUS and the TPP have included similar rules for goods imported in sets.

Updated Provision on Transit and Transshipment

Under the USMCA, an originating good that is transported outside the territories of the parties will retain its originating status if the good (1) remains under customs control in the territory of a non-Party; and (2) does not undergo an operation other than unloading; reloading; separation from a bulk shipment; storing; labeling or marking required by the importing Party; or any other operation necessary to preserve it in good condition or to transport the good to the territory of the importing Party. The NAFTA text did not expressly require a good to remain under customs control while in the territory of a non-Party in order to retain its originating status, though this concept is included in US Customs and Border Protection's NAFTA regulations. This additional requirement was also included in the TPP.

Product-Specific Rules of Origin

The USMCA's Annex 4-B contains significant revisions to many of the product-specific rules of origin found in Annex 401 of the NAFTA. Some of the revised rules, such as those applicable to automotive goods, are more stringent than the NAFTA rules, potentially forcing companies to alter their current supply chains in order to satisfy the new requirements. Other product-specific rules in the USMCA, such as those applicable to chemicals, might be more flexible than the existing NAFTA rules.

We provide below an illustrative list of sectors and products that are subject to revised product-specific rules of origin under the USMCA. Companies engaged in trade in the NAFTA region should carefully review the USMCA's product-specific rules of origin and assess the impact of any relevant changes.

Illustrative List of Products Subject to Revised Rules of Origin Under USMCA	
General Description of Goods	Relevant HS Chapter(s)
<ul style="list-style-type: none">Certain automotive goods¹⁰	Chapters 40, 70, 83, 84, 85, 87, 90, and 94
<ul style="list-style-type: none">Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	Chapter 27 ¹¹
<ul style="list-style-type: none">Inorganic chemicals; organic or inorganic compounds of	Chapters 28-38 ¹²

⁹ The value of the non-originating goods in the set and the value of the set must be calculated in the same manner as the value of non-originating materials and the value of the goods.

¹⁰ Automotive goods are subject to new product-specific rules of origin set forth in an Appendix to Annex 4-B of the USMCA. For an overview of these rules, please refer to the *W&C US Trade Alert dated October 4, 2018*.

¹¹ The USMCA provides that any good in Chapter 27 qualifies as originating if it is the product of a chemical reaction that occurred within the territory of one or more of the Parties (i.e., the "Chemical Reaction Rule"). The NAFTA did not include this option. Alternatively, goods classified in Chapter 27 will retain the option to qualify as originating through a change in tariff classification.

¹² The USMCA permits any good classified in Chapters 28-38 to qualify as originating if it satisfies one or more of eight new rules, pursuant to which specific production processes that occur within the region are sufficient to confer origin (with some exceptions): (1) the Chemical Reaction Rule; (2) the Purification Rule; (3) the Mixtures and Blends Rule; (4) the Change in Particle Size Rule; (5) the Standards Materials Rule; (6) the Isomer Separation Rule; (7) the Separation Prohibition Rule; and (8) the Biotechnological Processes Rule. Alternatively, goods classified in Chapters 28-38 retain the

Illustrative List of Products Subject to Revised Rules of Origin Under USMCA

General Description of Goods	Relevant HS Chapter(s)
precious metals, of rare-earth metals, of radioactive elements or of isotopes <ul style="list-style-type: none"> • Organic chemicals • Pharmaceutical products • Fertilizers • Tanning or dyeing extracts; dyes, pigments, paints, varnishes, putty and mastics • Essential oils and resinoids; perfumery, cosmetic or toilet preparations • Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial waxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modeling pastes, "dental waxes" and dental preparations with a basis of plaster • Albuminoidal substances; modified starches; glues; enzymes • Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations • Photographic or cinematographic goods • Miscellaneous chemical products 	
<ul style="list-style-type: none"> • Plastics and articles thereof • Rubber and articles thereof 	Chapters 39 and 40 ¹³
<ul style="list-style-type: none"> • Textile and apparel goods 	Chapters 42, 50-63, 70, 94, and 96 ¹⁴

option to qualify as originating through a tariff change and/or regional value content requirement, though some of these specific requirements have also changed from the NAFTA.

¹³ The USMCA permits any good classified in Chapters 39-40 to qualify as originating if it satisfies one or more of seven new rules, pursuant to which specific production processes that occur within the region are sufficient to confer origin (with some exceptions): (1) the Chemical Reaction Rule; (2) the Purification Rule; (3) the Mixtures and Blends Rule; (4) the Change in Particle Size Rule; (5) the Standards Materials Rule; (6) the Isomer Separation Rule; and (7) the Biotechnological Processes Rule. Alternatively, goods classified in Chapters 39-40 retain the option to qualify under a tariff change or regional value content requirement, though some of these specific requirements have also changed from the NAFTA.

¹⁴ The USMCA defines textile and apparel goods as falling within these chapters. The specific rules of origin for textile and apparel goods must be read in conjunction with Chapter 6 of the USMCA (Textiles and Apparel), which modifies aspects of the NAFTA's rules of origin for textiles, but these changes might not implicate all textile and apparel goods. For example, the USMCA requires that certain specific components of an apparel item must be originating in order for the finished apparel item to qualify as originating. For certain products, the USMCA also modifies the tariff preference levels set forth in the NAFTA (which permit specified quantities of non-originating yarns, fabrics, apparel and made-up textile goods to receive NAFTA tariff treatment, provided that they have undergone processing in one or more NAFTA countries). These changes will be addressed in a subsequent White & Case Trade Alert.

Illustrative List of Products Subject to Revised Rules of Origin Under USMCA

General Description of Goods	Relevant HS Chapter(s)
<ul style="list-style-type: none"> Certain articles of iron or steel (e.g., welded pipes and tubes, fittings, structures, wires, steel cloth, nails, tacks, and staples) 	Chapter 73 ¹⁵
<ul style="list-style-type: none"> Certain electronics and components (e.g. certain monitors and projectors, certain components used in telecommunications equipment, and certain electrical transformers and their parts) 	Chapter 85 ¹⁶
<ul style="list-style-type: none"> Certain parts of railway or tramway locomotives or rolling stock; containers 	Chapter 86 ¹⁷
<ul style="list-style-type: none"> Certain liquid crystal display (LCD) assemblies 	Chapter 90 ¹⁸

Outlook

Although most of the public discussion of the USMCA's rules of origin has focused on automotive goods, the Agreement's general and specific (non-automotive) rules also could have substantial implications for manufacturers and traders operating in North America. The Office of the US Trade Representative (USTR) has touted the updated rules of origin, including those for non-automotive goods, as a "key achievement" in the USMCA that will "ensure that only producers using sufficient and significant North American parts and materials receive preferential tariff benefits." Reactions within the US business community, however, have been mixed. For example, the private sector Advisory Committee for Trade Policy Negotiations (ACTPN) noted in its assessment of the Agreement that "[s]ome members of the ACTPN appreciate that the agreement strengthens the rules of origin, notably for steel-intensive goods, to ensure greater North American content. However, some other members believe the rules will raise costs and undercut the competitiveness of U.S. producers." Representatives of the apparel industry also have expressed concerns that the revised rules of origin applicable to that sector are overly restrictive and will discourage utilization of the USMCA, whereas representatives of the chemical sector have welcomed the simplicity of the new "process rules" applicable to chemical goods under the Agreement. Many other industry groups have not yet taken a position on the revised rules, which are highly technical and will require extensive analysis to determine their impact on specific products, companies, and industries.

¹⁵ The new rules applicable to certain steel-intensive goods will be phased in, taking effect 2-3 years after entry into force of the USMCA. They generally require that the product at issue: (1) undergoes a tariff shift from outside certain steel tariff headings in Chapters 72 and 73; (2) undergoes a tariff shift from only the designated steel tariff headings in Chapters 72 and 73, provided that at least 70% by weight of the inputs of those designated headings is originating; or (3) satisfies an RVC threshold (these vary by product, but generally range from 65-75% under the transaction value method or 55-65% under the net cost method.)

¹⁶ The changes in Chapter 85 vary by product. For example:

- The new rules applicable to electrical transformers and their parts will be phased in, taking effect 5 years after the USMCA enters into force. They generally require that the product at issue: (1) undergoes a tariff shift from outside certain headings in Chapters 72 and 73; or (2) satisfies an RVC requirement of 55% (net cost) or 65% (transaction value).
- Certain monitors and projectors will be able to qualify as originating without undergoing a change in tariff classification, provided they satisfy an RVC requirement of 60% (transaction value) or 50% (net cost).

¹⁷ The new rules applicable to certain parts of railway or tramway locomotives or rolling stock will be phased in, taking effect three years after the USMCA's entry into force. They generally require that the product at issue: (1) undergoes a tariff shift from outside certain steel tariff headings in Chapters 72 and 73; (2) undergoes a tariff shift from only the designated steel tariff headings in Chapters 72 and 73, provided that at least 70% by weight of the inputs of those designated headings is originating; or (3) satisfies an RVC requirement of 70% (transaction value) or 60% (net cost).

¹⁸ The new rules will enable certain LCD assemblies to qualify as originating without a change in tariff classification, provided they satisfy an RVC requirement of 40% (transaction value) or 30% (net cost).

Please let us know if you have any questions.

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