

NAFTA RULES OF ORIGIN: REGIONAL VALUE CONTENT

This document is meant to be a guide to the Rules of Origin provisions of the North American Free Trade Agreement. Exporters should keep in mind that only the NAFTA text itself and the customs regulations of each country that may be issued to implement NAFTA are definitive. For complex issues, or where interpretation is required, exporters should seek an advanced ruling from the Customs Administration of the country to which they are exporting.

The Use of Regional Value Content

The product specific rules of origin are found in Annex 401 of the NAFTA. Most products specific rules in Annex 401 are based solely on Harmonized System (HS) tariff classification changes. However, in limited cases, NAFTA requires a specified amount of "regional value content" in order for a good to obtain NAFTA tariff preference. For example, a rule might specify that at least 50% of the value of a product must be North American in order to qualify for NAFTA treatment.

Regional value content rules are used extensively for automotive goods and chemicals, but are quite limited in other product areas. *It is important to note that the regional value content test is not a generally available option for exporters, but may be used when specified in Annex 401 rules.*

Methodology for Calculating Regional Value Content

Regional value content may be calculated using two methods: transaction value or net cost; both formulas are shown in the box below. These methods involve subtracting the value of non-originating materials in a good to arrive at its percentage of North American content. Their difference lies in the cost basis used to make the calculation:

- Transaction value generally means the price actually paid or payable for a good.
- The net cost means total cost minus sales promotion, marketing and aftersales service costs, royalties, shipping and packing costs, and nonallowable interest costs that are included in the total cost

Because the transaction value is a broader basis for calculating content, the regional value content required is higher than for net cost. In most cases, the required level of regional value content is 60% for transaction value and 50% for net cost.

Transaction Value Formula

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

Net Cost Formula

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

RVC Regional value content, expressed as a percentage
TV Transaction value of good, adjusted to an FOB (free on board) basis
VNM Value of non-originating material used by the producer in the production of the good
NC Net cost of good

Generally, exporters and producers may choose which valuation methodology they prefer, but there are exceptions. For automotive goods, footwear and word processing machines, only the net cost method may be used. This is also true of goods for which there is no acceptable transaction value. Goods designated as "intermediate materials" and goods for which "accumulation" of regional value content is used, must also use the net cost method. There are other acceptations, please call the Trade Information Center at 1-800-USA-TRAD(E) for clarification.

Rules of Origin Example

Product: Wooden Furniture (HS # 9403.50)

Non-North American Inputs: Parts of furniture classified in 9403.90

Rule of Origin:

"A change to subheading 9403.10 through 9403.80 from any other chapter; or

A change to subheading 9403.10 through 9403.80 from subheading 9403.90, provided there is a regional value-content of not less than:

- a) 60 percent where the transaction value is used; or
- b) 50 percent where the net-cost method is used."

Explanation: Wooden furniture can qualify for NAFTA tariff preference under two scenarios -- a tariff shift, or a combination of a tariff shift and regional value content requirement.

The first option -- the tariff-shift rule -- requires that all non-originating inputs be classified outside of HS chapter 94 (furniture and bedding). Since the non-originating inputs (furniture parts) are classified in chapter 94, (subheading 9403.90), then the product cannot qualify based on tariff shift. However, it may still qualify based on the second part of the rule.

The second option has two components -- a tariff shift requirement, and a regional value content requirement. The tariff shift requirement is satisfied since the non-originating input (furniture parts) is classified in subheading 9403.90 as specified by the rule. The product must meet its regional value content requirement using the transaction value or the net cost methodology.

Given the following values, furniture qualifies for NAFTA tariff preference using the net cost methodology. The calculation is found below, with the following example.

Producer's Net Cost \$182.00 each (not including shipping, packing royalties, etc.)
Transaction Value \$200.00 each piece
Value of Non-Originating Parts \$90.00

Transaction Value Method

$$\frac{(200 - 90)}{200} \times 100 = 55$$

Good does not qualify under Transaction Value Regional requirement because it does not have at least 60 percent regional value content.

Net Cost Method

$$\frac{(182 - 90)}{182} \times 100 = 50.5$$

Good qualifies under Net Cost Regional Value requirement because it has at least 50 percent regional value content.

NAFTA Article 402: Regional Value Content

1. Except as provided in paragraph 5, each Party shall provide that the regional value content of a good shall be calculated, at the choice of the 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 exporter or producer may calculate the regional value content of a good on the basis of the following transaction value method:

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

where

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

TV is the transaction value of the good adjusted to a F.O.B. basis; and

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

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

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

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 used by the producer in the production of the good.

4. Except as provided in Article 403(1) and for a motor vehicle identified in Article 403(2) or a component identified in Annex 403.2, the value of non-originating materials used by the producer in the production of a good shall not, for 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 an 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 where:

- (a) There is no transaction value for the good;
- (b) The transaction value of the good is unacceptable under Article 1 of the Customs Valuation Code;
- (c) The good is sold by the producer to a related person and the volume, by units of quantity, of sales of identical or similar goods to related persons during the six-month period immediately preceding the month in which the good is sold exceeds 85 percent of the producer's total sales of such goods during that period; or
- (d) The good is
 - (i) a motor vehicle provided for in heading 87.01 or 87.02, subheading 8703.21 through 8703.90, or heading 87.04, 87.05 or 87.06,
 - (ii) identified in Annex 403.1 or 403.2 and is for use in a motor vehicle provided for in heading 87.01 or 87.02, subheading 8703.21 through 8703.90, or heading 87.04, 87.05 or 87.06,
 - (iii) provided for in subheading 6401.10 through 6406.10, or
 - (iv) provided for in tariff item 8469.10.aa (word processing machines);
- (e) The exporter or producer chooses to accumulate the regional value content of the good in accordance with Article 404;
- (f) The good is designated as an intermediate material under paragraph 10 and is subject to a regional value-content requirement.

6. If an exporter or producer of a good calculates the regional value content of the good on the basis of the transaction value method set out in paragraph 2 and a Party subsequently notifies the exporter or producer, during the course of a verification pursuant to Chapter Five (Customs Procedures), that the transaction value of the good, or the value of any material used in the production of the good, is required to be adjusted or is unacceptable under Article 1 of the Customs Valuation Code, the exporter or producer may then also calculate the regional value content of the good on the basis of the net cost method set out in paragraph 3.

7. Nothing in paragraph 6 shall be construed to prevent any review or appeal available under Article 510 (Review and Appeal) of an adjustment to or a rejection of:

- (a) The transaction value of a good; or
- (b) The value of any material used in the production of a good.

8. For 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, shipping and packing costs, and non-allowable interest costs that are included in the total cost of all such 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, shipping and packing costs and non-allowable interest costs that are included in the portion of the total cost allocated to the good; and

(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, shipping and packing costs, and non-allowable interest costs, provided that the allocation of all such costs is consistent with the provisions regarding the reasonable allocation of costs set out in the Uniform Regulations, established under Article 511 (Customs Procedures - Uniform Regulations).

9. Except as provided in paragraph 11, the value of a material used in the production of a good shall:

(a) Be the transaction value of the material determined in accordance with Article 1 of the Customs Valuation Code;

(b) In the event that there is no transaction value or the transaction value of the material is unacceptable under Article 1 of the Customs Valuation Code, be determined in accordance with Articles 2 through 7 of the Customs Valuation Code; and

(c) Where not included under subparagraph (a) or (b), include:

(i) freight, insurance, packing and all other costs incurred in transporting the material to the location of the producer,

(ii) duties, taxes and customs brokerage fees on the material paid in the territory of one or more of the Parties, and

(iii) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or by-product.

10. Except as provided in Article 403(1), any self-produced material, other than a component identified in Annex 403.2, 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, provided that where 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.

11. The value of an intermediate material shall be:

(a) The total cost incurred with respect to all goods produced by the producer of the good that can be reasonably allocated to that intermediate material; or

(b) The aggregate of each cost that forms part of the total cost incurred with respect to that intermediate material that can be reasonably allocated to that intermediate material.

12. The value of an indirect material shall be based on the Generally Accepted Accounting Principles applicable in the territory of the Party in which the good is produced.

