

CHAPTER THREE

RULES OF ORIGIN

Article 3.01: Definitions

For purposes of this Chapter:

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

customs value means the value as determined under the Customs Valuation Agreement;

fungible goods means goods that are interchangeable for commercial purposes and whose properties are essentially identical;

fungible materials means materials that are interchangeable for commercial purposes and whose properties are essentially identical;

Generally Accepted Accounting Principles means the principles used in the territory of each Party that provide substantial authorized support with regard to the recording of income, costs, expenses, assets and liabilities involved in the disclosure of information and preparation of financial statements; these principles may be broad guidelines of general application, as well as those standards, practices and procedures usually employed in accounting;

good includes a product, article or material;

good wholly obtained or produced entirely in the territory of one or both of the Parties means:

- (a) a mineral or other non-living natural resource extracted in or taken from the territory of one or both of the Parties;
- (b) a plant or plant product harvested in the territory of one or both of the Parties;
- (c) a live animal born and raised in the territory of one or both of the Parties;
- (d) a good obtained from a live animal in the territory of one or both of the Parties;
- (e) a good obtained from hunting, trapping, fishing or aquaculture in the territory of one or both of the Parties;
- (f) fish, shellfish or other marine life taken from the sea, seabed or subsoil outside the territory of one or both of the Parties by a vessel registered, recorded or listed with a Party, or a vessel leased by a company established in the territory of a Party, and entitled to fly its flag, except any good subject to a regulation adopted pursuant to the *Special Economic Measures Act*, S.C. 1992, c. 17, as amended;
- (g) a good produced on board a factory vessel from the goods referred to in subparagraph (f), provided the factory vessel is registered, recorded or listed with a Party, or leased by a company established in the territory of a Party, and entitled to fly its flag;

- (h) a good, other than fish, shellfish or other marine life, taken or extracted from the Area, as defined in Article 1(1) of the UNCLOS, by a vessel registered, recorded or listed with a Party and entitled to fly its flag, or by a Party or a person of a Party;
- (i) a good taken from outer space, provided it is obtained by a Party or a person of a Party and not processed in a non-Party;
- (j) waste and scrap derived from production in the territory of one or both of the Parties;
- (k) raw material or a component recovered from a used good collected in the territory of one or both of the Parties, provided the good is fit only for such recovery; this includes such raw materials and components for use in the production of remanufactured goods; or
- (l) a good produced in the territory of one or both of the Parties exclusively from a good referred to in subparagraphs (a) through (k), or from its derivatives;

indirect material means a good used in the production, testing or inspection of a good but not physically incorporated into the good, or a good 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 moulds;
- (c) a spare part or material used in the maintenance of equipment or buildings;

- (d) a lubricant grease, compounding material or other material used in the production or operation of equipment or buildings;
- (e) gloves, glasses, footwear, clothing, and safety equipment and supplies;
- (f) equipment, devices, and supplies used for testing or inspecting the good;
- (g) a catalyst or solvent; or
- (h) any other good that is not incorporated into the good but whose 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 produced by a producer of a good and used in the production of that good;

listed with a Party means a foreign registered vessel bare-boat chartered to a Canadian citizen, a permanent resident of Canada or a Canadian corporation which is listed in the Canadian Register of Vessels for the duration of the charter and whose registration in the foreign country is suspended for the duration of the charter;

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

mola (or morra in the native Kuna language) means a good, traditional and historic in nature, produced in the territory of Panama through reverse appliqué of small decorative pieces of cloth onto a larger piece, elaborated back to front with a combination of fabrics of different bright colours; a mola is made up by hand in two or more layers of cut fabrics, hand sewn one over the other, and is usually inspired in nature, cosmic view, or geometrical designs;

net cost means total cost minus 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;

non-allowable interest costs means interest costs incurred by a producer that exceed the applicable national government interest rate identified for comparable maturities by more than 700 basis points;

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

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

other costs means all costs that are not product costs or period costs;

period cost means a cost other than product cost that is expensed in the period in which it is incurred, including a selling expense or a general and administrative expense;

product cost means a cost that is associated with the production of a good and includes the value of material, direct labour cost or direct overhead;

producer means a person who grows, mines, raises, harvests, fishes, traps, hunts, manufactures, processes, assembles or disassembles a good;

production means growing, mining, raising, harvesting, fishing, trapping, hunting, manufacturing, processing, assembling or disassembling a good;

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

remanufactured good means a good that is entirely or partially comprised of a recovered good;

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

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

sales promotion, marketing and after-sales service cost means a cost related to:

- (a) sales or marketing promotion; media advertising; advertising or market research; promotional or demonstration materials; exhibits; sales conferences, trade shows and conventions; banners; marketing displays; free samples; sales, marketing or after-sales service literature (product brochures, catalogues, technical literature, price lists, service manuals, sales aid information); establishment or protection of logos or trademarks; sponsorships; wholesale or retail restocking charges; entertainment;
- (b) sales or marketing incentives; consumer, retailer or wholesaler rebates; merchandise incentives;
- (c) salaries or wages, sales commissions, bonuses, benefits (for example, medical, insurance, pension), travelling or living expenses, membership and professional fees for sales promotion, marketing or after-sales service personnel;

- (d) recruiting or training of sales promotion, marketing or after-sales service personnel or after-sales training of customers' employees, where these costs are identified separately for sales promotion, marketing or 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 or after-sales service of goods, where such costs are identified separately for sales promotion, marketing or after-sales service of goods on the financial statements or cost accounts of the producer;
- (g) telephone, mail and other communications, where such costs are identified separately for sales promotion, marketing or after-sales service of goods on the financial statements or cost accounts of the producer;
- (h) rent or depreciation of sales promotion, marketing or after-sales service offices or distribution centres;
- (i) property insurance premiums, taxes, cost of utilities, or cost of repair or maintenance of sales promotion, marketing or after-sales service offices or distribution centres, where these costs are identified separately for sales promotion, marketing or after-sales service of goods on the financial statements or cost accounts of the producer; or
- (j) payments by the producer to other persons for warranty repairs;

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

tariff provision means a chapter, heading or subheading of the Harmonized System;

total cost means a product cost, period cost, or other cost incurred in the territory of one or both of the Parties;

transaction value means the price actually paid or payable for a good, including a material, with respect to a transaction of the producer of the good, adjusted in accordance with the principles of Article 8(1), (3) and (4) of the Customs Valuation Agreement to include, among other things, such costs as commissions, production assists, royalties or license fees;

transaction value of the good, or transaction value of the set or assortment means:

- (a) the transaction value of the good or the transaction value of the set or assortment when sold by the producer at the place of production, or
- (b) the customs value of the good or the set or assortment,

and adjusted, if necessary, to exclude any cost incurred subsequent to the good leaving the place of production, such as freight and insurance; and

value of a non-originating material means:

- (a) the transaction value or the customs value of the material at the time it is imported into a Party, adjusted, if necessary, to include freight, insurance, packing or other costs incurred in transporting the material to the place of importation; or
- (b) in the case of a domestic transaction, the value of the material determined in accordance with the principles of the Customs Valuation Agreement in the same manner as an international transaction, with any modification required by the circumstances.

Article 3.02: Originating Goods

Except as otherwise provided in this Chapter, a good originates in the territory of a Party where:

- (a) the good is wholly obtained or produced entirely in the territory of one or both of the Parties;

- (b) each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification as set out in Annex 3.02 as a result of production occurring entirely in the territory of one or both of the Parties, or the good otherwise satisfies the applicable requirements of that Annex where a change in tariff classification is not required, and the good satisfies all other applicable requirements of this Chapter;
- (c) the good is produced entirely in the territory of one or both of the Parties exclusively from originating materials; or
- (d) except as provided in Annex 3.02 or except for a good of heading 39.01 through 39.14 or Chapters 50 through 63 of the Harmonized System:
 - (i) the good is produced entirely in the territory of one or both of the Parties,
 - (ii) a non-originating material used in the production of the good cannot satisfy the requirements set out in Annex 3.02 because both the good and the non-originating material are classified in the same subheading or heading that is not further subdivided into subheadings,
 - (iii) the value of a non-originating material used in the production of the good, classified as or with the good, does not exceed 65 per cent of the transaction value of the good, and
 - (iv) the good satisfies the other applicable requirements of this Chapter.

Article 3.03: Certain Textile and Apparel Goods

Mola, or textile or apparel goods that incorporate mola, that are both cut or knit to shape, and sewn or otherwise assembled in the territory of one or both of the Parties originate in the territory of a Party.

Article 3.04: Value Test

1. Except as provided in paragraph 2, where the applicable rule of origin in Annex 3.02 for the tariff provision under which a good is classified specifies a value test, the value test is satisfied provided the value of all non-originating material used in the production of the good does not exceed the percentage specified in Annex 3.02 of the transaction value of the good under the following formula:

Value of non-originating material used in the production of the good as a percentage of the transaction value of the good =

$$\frac{\text{Value of Non-Originating Material} \times 100}{\text{Transaction Value of the Good}}$$

2. For the purpose of a good of headings 87.01 through 87.08, at the choice of an exporter or a producer of that good, the value test is satisfied if the value of a non-originating material used in the production of the good does not exceed the percentage specified in Annex 3.02 of either the transaction value or the net cost of the good.

3. The value of all non-originating material used by the producer in the production of a good does not, for the purposes of satisfying the value test under either paragraph 1 or 2, include the value of all non-originating material used to produce originating material that is subsequently used in the production of the good.

4. For the purpose of paragraph 3, the value of a non-originating material in paragraphs 1 and 2 does not include:

- (a) the value of all non-originating material used by another producer to produce an originating material that is subsequently acquired and used in the production of the good by the producer of the good; or
- (b) the value of all non-originating material used by the producer to produce an originating intermediate material.

5. For the purpose of calculating the net cost of a good under paragraph 2, 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 cost, royalty, shipping and packing cost, as well as a non-allowable interest cost that is 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 cost, royalty, shipping and packing cost and non-allowable interest cost that is 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 cost, royalty, shipping and packing cost, or non-allowable interest cost.
6. For the purpose of this Article, value of an intermediate material means:
- (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 sum of all costs that comprise the total cost incurred with respect to that intermediate material that can be reasonably allocated to that intermediate material.

Article 3.05: Accumulation

1. For the purpose of determining whether a good is an originating good, the production of the good in the territory of one or both of the Parties by one or more producer is, at the choice of the exporter or producer of the good, considered to have been performed in the territory of either of the Parties by that exporter or producer, if:

- (a) all non-originating materials used in the production of the good satisfy the requirements set out in Annex 3.02, entirely in the territory of one or both of the Parties; and
- (b) the good satisfies all other applicable requirements of this Chapter.

2. Subject to paragraph 3, where each Party has a trade agreement that establishes or leads to the establishment of a free trade area with the same non-Party, as contemplated by the WTO Agreement, the territory of that non-Party is deemed to form part of the territory of the free trade area established by this Agreement, for the purpose of determining whether a good is an originating good under this Agreement.

3. A Party shall give effect to paragraph 2 only once provisions with an effect equivalent to paragraph 2 are in force between each Party and the non-Party, and upon agreement by the Parties on whether to limit such provisions to specified goods or under specified conditions.

Article 3.06: *De Minimis*

1. Except as provided in paragraphs 2 through 4, a good is an originating good if the value of all non-originating material used in the production of the good that does not undergo an applicable change in tariff classification set out in Annex 3.02 does not exceed 10 per cent of the transaction value of the good, if:

- (a) when the rule of origin of Annex 3.02 applicable to the good contains a percentage for the maximum value of non-originating materials, the value of that non-originating material is included in calculating the value of a non-originating material; and
- (b) the good satisfies all other applicable requirements of this Chapter.

2. Except as provided in Annex 3.02, paragraph 1 does not apply to a non-originating material used in the production of a good of Chapters 1 through 22 of the Harmonized System unless the non-originating material is provided for in a different subheading from the good for which origin is being determined under this Article. However, paragraph 1 does apply when the good and the non-originating material are classified in the same subheading, provided that the material is different from the good.

3. A good of Chapters 50 through 60 of the Harmonized System that does not originate because certain non-originating yarns used in the production of the good do not fulfil the requirements set out in Annex 3.02 is nonetheless originating if the total weight of all those yarns does not exceed 10 per cent of the total weight of the good.

4. A good of Chapters 61 through 63 of the Harmonized System that does not originate because certain non-originating yarns used in the production of the component of the good that determines the tariff classification of that good do not fulfil the requirements set out in Annex 3.02, is nonetheless originating if the total weight of all those yarns in that component does not exceed 10 per cent of the total weight of that component.

Article 3.07: Fungible Materials and Goods

For the purpose of determining whether a good is an originating good, if:

- (a) originating and non-originating fungible material are used in the production of a good, the determination of whether the fungible material is originating may be made in accordance with an inventory management method recognized in, or otherwise accepted by, the Generally Accepted Accounting Principles of the Party in which the production takes place; and
- (b) originating and non-originating fungible goods are physically combined or mixed in inventory in a Party and exported in the same form to the other Party, the determination of whether the good is an originating good may be made in accordance with an inventory management method recognized in, or otherwise accepted by, the Generally Accepted Accounting Principles of the Party from which the good is exported.

Article 3.08: Sets or Assortments of Goods

1. Except as provided in Annex 3.02, a set, as referred to in Rule 3 of the *General Rules for the Interpretation of the Harmonized System*, or an assortment of goods is originating if:

- (a) all the component goods in the set or assortment, packaging materials and containers, are originating; or
- (b) the set or assortment contains a non-originating component good, packaging material or container, the value of all non-originating component goods, packaging materials and containers for the set or assortment, does not exceed 15 per cent of the transaction value of the set or assortment.

2. The value of a non-originating component good, packaging material or container is calculated in the same manner as the value of a non-originating material.

Article 3.09: Accessories, Spare Parts and Tools

An accessory, spare part or tool delivered with the good that forms part of the good's standard accessories, spare parts or tools, is originating if the good is originating. The accessory, spare part or tool is disregarded in determining whether all the non-originating materials used in the production of the good satisfy the requirements set out in Annex 3.02, if:

- (a) the accessory, spare part or tool is not invoiced separately from the good;
and
- (b) the quantity and value of the accessory, spare part or tool are customary for the good.

Article 3.10: Indirect Materials

An indirect material is originating without regard to where it is produced.

Article 3.11: Intermediate Materials Used In Production

1. If an intermediate material is originating, no account is taken of non-originating material contained in that intermediate material when it is subsequently used in the production of another good.
2. For the purpose of determining the origin of a good, a producer of a good may designate an intermediate material as a material to be taken into account as an originating or non-originating material, as the case may be, in determining whether the good satisfies the applicable requirements of the rules of origin.

Article 3.12: Packaging Materials and Containers for Retail Sale

Except as provided in Article 3.08 and Annex 3.02, a packaging material or container in which a good is packaged for retail sale is disregarded in determining whether:

- (a) the non-originating material satisfies the applicable requirements set out in Annex 3.02; or
- (b) the good meets the requirements established in Article 3.02(a) or (c).

Article 3.13: Packing Materials and Containers for Shipment

A packing material, container, pallet or similar article, in which a good is packed for shipment is disregarded in determining whether that good is originating.

Article 3.14: Transit and Transshipment

1. An originating good that is exported from a Party maintains its originating status only if the good:

- (a) does not undergo further production or any other operation outside the territories of the Parties, other than unloading, reloading or any other operation necessary to preserve it in good condition or to transport the good to the territory of a Party; and
- (b) remains under customs control while outside the territories of the Parties.

2. The Parties recognize that a good qualifying as an originating good under a trade agreement between a Party and a non-Party, which establishes or leads to the establishment of a free trade area, does not lose its originating status under that agreement solely by reason of transiting or being transhipped through a Party's territory or by reason of the wholesale purchase or sale of that good in a Party's free trade zone, if all the conditions required under the applicable provisions of that agreement are met.

Article 3.15: Interpretation and Application

For the purpose of this Chapter:

- (a) the basis for tariff classification in this Chapter is the Harmonized System;
- (b) where applying Article 3.02(d), the determination of whether a heading or subheading under the Harmonized System provides for both a good and the material that is used in the production of the good is made on the basis of the nomenclature of the heading or subheading and the relevant Section or Chapter Notes, in accordance with the *General Rules for the Interpretation of the Harmonized System*; and
- (c) costs referred to in this Chapter must be recorded and maintained in accordance with the Generally Accepted Accounting Principles applicable in the territory of the Party in which the good is produced.

Article 3.16: Consultation and Modifications

1. The Parties shall consult regularly to ensure that this Chapter is administered effectively, uniformly and consistently with the spirit and objectives of this Agreement, and shall cooperate in the administration of this Chapter in accordance with Chapter Four (Customs Procedures).

2. A Party that considers that this Chapter requires modification to take into account developments in production processes or other matters may submit a proposed modification along with supporting rationale and any studies to the other Party for consideration and appropriate action by the Committee on Trade in Goods and Rules of Origin.