Annex 3-04

Calculation of Net Cost

Section A - Definitions.

For purposes of this Annex:

**allocation base** means any of the following allocation bases that are used by the producer for calculating the cost ratio with respect to the good:

(a) the sum of the direct labor costs and the direct material costs of the good;
(b) the sum of the direct labor costs, the direct material costs and the direct overhead of the good;
(c) direct labor hours or direct labor costs;
(d) units produced;
(e) machine-hours;
(f) sales amount;
(g) floor space; or
(h) any other allocation bases that are considered reasonable and measurable;

**internal management purpose** means any procedure for costs allocation that is used for purposes relating to tax reporting, financial reporting, internal control, financial planning, decision-making, pricing, cost recovery, cost control management or performance measurement; and

**non-allowable costs** means sales promotion, marketing and after-sales service costs; royalties, shipping and repackaging costs.

Section B - Calculation of the Net Cost.

1. The net cost is calculated in accordance with the following formula:

\[ NC = TC - NAC \]

where:

NC: net cost.
TC: total cost.
NAC: non-allowable costs.

2. For purposes of calculating the total cost:

(a) the producer of the good may choose to average the total cost with respect to the good and other identical or similar goods produced in a single plant by the producer over:

(i) a month; or

(ii) any consecutive period longer than a month that is evenly divisible into the number of months of the producer’s fiscal year or period;

(b) for purposes of subparagraph (a), the producer of the good shall consider all the good’s units produced within the chosen period. The producer may not rescind or modify that period, once elected;

(c) for purposes of calculating total cost, where the producer of the good is using, for an internal management purpose, a cost allocation method to allocate to the good the direct material costs, the direct labor costs or the direct or indirect overhead or part thereof, and that method reasonable reflects the direct material costs, the direct labor costs or direct or indirect overhead incurred in the production of the good, that method shall be considered as a method to reasonable allocate costs and shall be used to allocate the costs to the good;

(d) the producer of the good may determine a reasonable costs amount, when those costs have not been allocated to the good, as follows:

(i) with respect to direct material costs and direct labor costs, on the basis of any method that reasonably reflects the direct material and direct labor used in the production of the good; and

(ii) with respect to direct and indirect overhead, the producer of the good may choose one or more allocation bases that reflect a relationship between the overhead and the good, in accordance with subparagraphs (f) and (g);

(e) the producer of the good may choose any reasonable costs allocation method, which shall be used throughout the producer’s fiscal year or period;

(f) with respect to each allocation base, the producer may choose to calculate a cost ratio for each good produced, in accordance with the following formula:

\[
\text{CR} = \frac{\text{AB}}{\text{TAB}} \times 100
\]

where

CR: cost ratio with respect to the good;
AB: allocation base for the good; and

TAB: total allocation base for all the goods produced by the producer of the good.

(g) the costs with respect to which an allocation base is chosen are allocated to a good in accordance with the following formula:

\[ CAG = CA \times CR \]

where

CAG: costs allocated to the good;

CA: costs to be allocated; and

CR: cost ratio with respect to the good.

(h) for purposes of calculating the net cost, where non-allowable costs are included in the total cost to be allocated to a good, the cost ratio used to allocate those costs to the good shall be used to determine the amount of non-allowable costs to be subtracted from the total cost allocated to the good; and

(i) any costs allocated in accordance with any reasonable costs allocation method that is used for internal management purpose are considered not to be reasonable allocated, when it may be demonstrated, on the basis of a preponderance of evidence, that the object was to circumvent the provisions of this Chapter.

3. Where the producer of a good has calculated the regional value content of the good under the net cost method on the basis of estimated costs (including standard costs, budgeted forecasts or other similar estimating procedures), before or during the chosen period, as set out in paragraph 2 (a), the producer shall conduct an analysis, at the end of the producer’s fiscal year or period, of the actual costs incurred over that period with respect to the production of the good, in accordance with the provisions of this Annex.