briefing

harwoodhutton
accountants
www.harwoodhutton.co.uk

June 2019

Preferential Origin: Why it pays to know the rules

By **Ian Worth**
Head of Harwood Hutton Customs and International Trade
ianworth@harwoodhutton.co.uk
07960 858203

Many UK exporters use the preferential origin arrangements of Free Trade Agreements (FTAs) to support the competitiveness of their goods when sold overseas. These arrangements enable an overseas customer to pay a 'preferential' rate of customs duty when they import eligible goods into their country, rather than the full rate of customs duty which is otherwise applicable. The savings for a customer can be significant, which increases pressure on a UK exporter to declare that their goods are eligible for preference.

Exporting goods from the UK does not automatically mean that those goods qualify for preference. There are strict and often complex rules of origin which must be fulfilled. This can be straightforward for goods which are grown, farmed or mined here (wholly produced) but becomes more complex for goods which are manufactured, or processed, particularly when imported materials or components are involved and where manufacturing may involve several countries.

A declaration by an exporter that the goods being exported meet the necessary origin criteria for preferential trade with a FTA partner country is a legal declaration that the declarant understands the relevant rules of origin and that its goods qualify. It is the basis of this declaration that allows the overseas customer to pay less customs duty at import.

When checking goods exported from the United Kingdom, customs authorities in import countries often seek confirmation from HMRC that where preference is claimed, the goods actually meet the relevant preferential origin criteria. If they find that goods do not qualify, following investigation, the exporter could face penalties, and his/her customer could face a demand for underpaid customs duty.

Any importer claiming preference should not do so merely by accepting the supplier's origin declaration at face value but should also undertake due-diligence on the supplier to gain confidence in the declaration.

A UK manufacturer should understand the origin rules which apply to the goods it exports, as they apply for trade with the country of destination. The rules differ depending on the product and are reliant on accurate tariff classification, so the whole system hinges on having the correct commodity code to start with. This is often overlooked, with few exporters having expertise in tariff classification, in many cases simply relying on old established habits.

An incorrect commodity code can result in an incorrect preferential rule being applied, and although inaccuracies are rarely detected at the time, a subsequent customs audit can expose a significant problem, leading to penalties from HMRC and the customs authority of the importer, resulting in issues for customers.

Currently, goods exported from the UK can qualify for preferential origin by including content which originates elsewhere in the EU. To the extent that the UK is party to any FTAs following Brexit, this might no longer be

the case. Similarly, goods exported from the EU which rely on UK content to meet the origin rule may no longer qualify after the UK has left the EU. Apart from knowledge of how to classify goods for customs purposes and how to apply the correct rules of origin, the exporter needs knowledge of the product and its manufacturing process. The exporter may need to know the cost and origin of any materials or components purchased from other suppliers.

Origin qualification can be affected by a change in supplier, price changes or even currency fluctuation, which may require regular monitoring of bills of material. Additionally, many rules of origin require a calculation of the value of non-originating content as a percentage of the ex-works selling price, so any discount agreed by the sales team could skew the calculation and affect qualification for preferential origin. Many origin rules also look at the ex-works price, so if another term is being used in the transaction, allowances for this should be made.

If goods do not meet preferential origin criteria, it is usually because the proportion of imported materials or components is too high. If this is the case, the manufacturer may be eligible to claim duty relief on his imported materials or components, enabling him to strip out the cost of UK customs duty from his manufacturing activity, rather than passing the cost on to customers, reducing overseas competitiveness.

The drawbacks of FTAs are seldom explained by those who talk of the UK's future trading relationships after Brexit. There are no trade benefits where goods do not meet the relevant origin criteria. The rules of origin are strict, and compliance can be onerous, but for those businesses which manage their preferential export obligations effectively, they are a valuable tool to support overseas sales.