



UNITOUCH

FREE TRADE AGREEMENT BETWEEN CHINA AND SWITZERLAND

-

RULES OF ORIGIN AND RELEVANT ISSUES

HAN Bingshuang*

*HAN Bingshuang, LLM, Partner at Unitouch Services Ltd.

**Although this paper is prepared with carefulness and industry, it is only for information purpose and shall not be considered as legal advice or business advice. Neither Unitouch nor the author of this paper provide any kind of guarantee with respect to the completeness and accuracy of its contents. Unitouch or the author of this paper shall not be liable for any damage caused by this work. If any legal advice or business advice is desired by the reader, qualified legal advisor or business advisor shall be consulted for such purpose.

The entering into force of the Free Trade Agreement between China and Switzerland (hereinafter, the “Sino-Swiss FTA”) marks a milestone in the economic and trade cooperation between the two countries. As the first European continental country to sign free trade agreement with China,¹ Switzerland will finally have 96.5% of its products exported to China being subjected to tariff reduction, while China, the world second largest economy, will see 99.99% of its product receiving tariff reduction from Switzerland among which 99.7% products immediately received the tariff-free treatment upon the entering into force of the Sino-Swiss FTA in July 2014.²

Without any doubt, most manufactures and traders involved in Sino-Swiss commercial activities are delightedly embracing the free trade era between China and Switzerland. However, not all products will enjoy such treatment: it is necessary to assure that preferential treatments granted by the Sino-Swiss FTA can be applied to the relevant products, which mostly depend on their originating status. Therefore, an understanding of the rules of origin under the Sino-Swiss FTA is a precondition to determine whether products will receive preferential treatment.

This paper aims to offer an overview of rules of origin under the Sino-Swiss FTA, with focus on originating status of products and some relevant issues. In the first part, the rules regarding the origins of products will be examined, and in the second part the testing rules of substantial transformation, which is crucial to determine a product’s originating status, will be analyzed. In the third part, a discussion of certain originating status related issues will be conducted, followed by a simple conclusion at the end of the paper.

¹ Chen Jian, *Opening the New Age of Sino-Swiss Economic and Trade Cooperation*, *Economic Daily*, 1st July 2014, P6.

²Zhang Ying, *Approaching Zero Tariff*, *International Financial News*, 8th July 2013, P1.

I. ORIGINATING PRODUCTS

Per definition, originating products are products originating in a Party (hereinafter, China or Switzerland) to the Sino-Swiss FTA. Being an originating product is the premise of enjoying preferential tariff treatment conferred by the Sino-Swiss FTA.

According the Sino-Swiss FTA, three categories of products shall be considered as originating in a Party:³

1. Wholly Obtained Products

Wholly obtained products are understood as:

- a) Products wholly obtained in a Party, or
- b) Products produced by a Party exclusively from products wholly obtained in a Party.

Wholly obtained products are explained in Article 3.3 of the Sino-Swiss FTA together with a minute list of all products that fall into this category.

2. Products Undergone Substantial Transformation

A product is considered as originating in a Party if “the *non*-originating materials used in the working or processing of such product have undergone substantial transformation in a Party”.⁴ Rules with respect to substantial transformation are stipulated in Chapter 3 and Annex II of the Sino-Swiss FTA based on which three testing rules regarding substantial transformation, which will be explained below, are provided.⁵

³ See Article 3.2 of the Sino-Swiss FTA; full text of the Sino-Swiss FTA is available at http://fta.mofcom.gov.cn/ruishi/ruishi_xieyi.shtml, accessed on 26 November 2014.

⁴ See Article 3.2(b) of the Sino-Swiss FTA.

⁵ See Article 3.4 and Annex II of the Sino-Swiss FTA.

3. Products Produced Exclusively From One or Both Parties

A product shall be considered as originating in a Party if it has been produced in a Party exclusively from originating materials of one or both Parties.⁶

In general, it is not hard to judge whether a product qualifies as a wholly obtained product or a product produced exclusively from one or both Parties. Attention shall be given to the situation where products are not exclusively produced in one or both Parties, but undergo a substantial transformation. In such cases, different testing rules may be applicable in order to decide whether a product qualifies as originating from a Party, in cases where non-originating materials are used in the working or processing of such product.

II. TESTING RULES FOR SUBSTANTIAL TRANSFORMATION

Three kinds of testing rules for determining substantial transformation are worldwide mostly employed:

- a) Rule of the change of tariff code,
- b) Rule of regional value, and
- c) Special rules.

Under the rule of the change of tariff code, the fact that the tariff code of a product has been changed because of production or processing activities occurred in a country shall qualify such product as having “undergone substantial transformation” in such a country. Under the rule of regional value, if the percentage of the value of materials originating in a country contained in a product produced or processed in such a country reaches the pre-defined level, this product shall be considered as

⁶ See Article 3.2(c) of the Sino-Swiss FTA.

undergone substantial transformation in this country. Special rules may apply for products with special nature or due to special policy considerations.

The Sino-Swiss FTA adopts those rules and applies them to different situations, either individually or combined. Special attention shall be paid to the second testing rule: rule of regional value. In the Sino-Swiss FTA, the methodology of reverse calculation is employed for assessing the satisfaction of regional value requirements in order to decide whether originating status can be acquired. This means that a product is considered to have undergone substantial transformation if the value of non-originating material (hereinafter, the “VNM”) does not exceed a pre-set percentage (hereinafter, the “VNM%”) in relation to ex-works price.

As those three kinds of testing rules are adopted to define the substantial transformation criteria under the Sino-Swiss FTA, three scenarios can be normally identified under the Sino-Swiss FTA.

1. One Testing Rule Applies

For many products, the Sino-Swiss FTA provides only one testing rule to determine whether a product meet the requirements of substantial transformation. This is either the rule of change of tariff classification or the rule of regional value. For example, for products under Chapter 85⁷ of HS⁸, it provides “VNM 50%”, which means the substantial transformation of a product has been undergone if the value of non-originating materials used for producing such a product does not exceed 50% of the ex-works prices of such a product.

⁷ See Annex II of the Sino-Swiss FTA which is based on HS Nomenclature (2012 Edition), Chapter 85: electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles; full text of the Annex II is available at: http://fta.mofcom.gov.cn/ruishi/xieyi/fujian_02_en.rar, accessed on 26th November 2014.

⁸ The Annex II of the Sino-Swiss FTA is formulated on the basis of HS Nomenclature (2012 Edition); HS Nomenclature (2012 Edition) is available at: http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs_nomenclature_2012/hs_nomenclature_table_2012.aspx, accessed on 26th November 2014.

2. Two Testing Rules Provided and One of Them Applies

The Sino-Swiss FTA allows certain products to be tested by one of two provided rules. For example, for products under Chapter 33⁹ of HS, it provides “CTH or VNM 60%”, which means substantial transformation shall be deemed undergone if four-digital level HS code change of a product occurs or the value of non-originating materials stays no more than 60% of the ex-works prices of a product.

3. Special Rules Apply

In consideration of the special nature of certain products or special policy reasons, the Sino-Swiss FTA imposes special rules, independently or combined, for the testing of substantial transformation of products. For example, for all products under Chapter 27-40, there are additional rules stipulated in Section II of Annex II of the Sino-Swiss FTA, such as “the origin of the product is the country where the transformation took place”.¹⁰

III. ORIGINATING STATUS RELATED ISSUES

With respect to rules regarding originating status, the Sino-Swiss FTA provides other determinants that shall be assessed in judging the originating status of a product, such as the formulation of VNM%,¹¹ *de minimis*,¹² minimal operations or processes,¹³ accumulation,¹⁴ neutral elements¹⁵ and fungible materials.¹⁶ Analyses of some most relevant issues are provided in the following paragraphs.

⁹ See Annex II of the Sino-Swiss FTA, Chapter 33: essential oils and resinoids; perfumery, cosmetic or toilet preparations, available at: http://fta.mofcom.gov.cn/ruishi/xieyi/fujian_02_en.rar, accessed on 26th November 2014.

¹⁰ Section II.1 of Annex II of the Sino-Swiss FTA.

¹¹ Article 3.4 of the Sino-Swiss FTA.

¹² Article 3.5 of the Sino-Swiss FTA.

¹³ Article 3.6 of the Sino-Swiss FTA.

¹⁴ Article 3.7 of the Sino-Swiss FTA.

¹⁵ Article 3.10 of the Sino-Swiss FTA.

¹⁶ Article 3.11 of the Sino-Swiss FTA.

1. The Formulation of VNM%

The formulation of calculating the VNM% is prescribed as follows:¹⁷

$$\text{VNM\%} = \frac{\text{VNM}}{\text{EX-WORKS PRICE}} * 100$$

The basis of the VNM is the custom value of non-originating materials at their time of importation. If aforementioned custom value cannot be known or ascertained, the “first ascertainable price paid or payable” for such non-originating materials in a Party to the Sino-Swiss FTA shall apply.¹⁸

2. Originating Products as Materials

Concerns shall be raised as to whether products that acquire the originating status by undergoing substantial transformation can be considered as 100% originating materials should such products be used as materials for the production of new products, or whether the non-originating components of such products shall be taken into account when deciding the originating status of the new products. The Sino-Swiss FTA provides clear solution for this issues in Paragraph 5 of Article 3.4: “no account shall be taken of the non-originating components of that material in the determination of the originating status of the product.”¹⁹

3. Minimal Operations or Processes (*De Minimis*)

In most FTAs concluded by China in recent years, minimal operations or processes is explicitly excluded from the criteria of deciding a product’s originating status. So does the Sino-Swiss FTA. In Article 3.6 of the Sino-Swiss FTA, the rules regarding the denying of minimal operations or processes as shaping factor of originating

¹⁷ Para 3 of Article 3.4 of the Sino-Swiss FTA.

¹⁸ Para 4 of Article 3.4 of the Sino-Swiss FTA.

¹⁹ Para 5 of Article 3.4 of the Sino-Swiss FTA.

status are clearly stipulated. Packaging, re-packaging, washing, simple painting and polishing, sharpening, simple grinding, etc. are explicitly listed as minimal operations or processes.²⁰

4. Neutral Elements

Neutral elements which are used in production but not physically incorporated into products shall not be regarded as influential factors with respect to determining a product's originating status.²¹ Article 3.10 offers a non-exhaustive list of such neutral elements, such as fuel, energy, tools and lubricants.

IV. CONCLUSION

The Sino-Swiss FTA opens tremendous opportunities for the Sino-Swiss business communities and will drive the Sino-Swiss economic and trade cooperation to a new level. The Swiss high quality and reputable products will find themselves standing on a paved highway leading to the enormous Chinese market while Chinese products will enjoy almost free entry into a highly-developed and mature market. However, all these preferential treatments are only available if a product satisfies relevant requirements under rules of origin. Therefore, a deep understanding of the rules of origin regime under the Sino-Swiss FTA, especially of the rules relating to the originating status, becomes not only beneficial but also necessary in order to profit from this landmark free trade agreement.

²⁰ Article 3.6 of the Sino-Swiss FTA.

²¹ Article 3.10 of the Sino-Swiss FTA.

UNITOUCH Services Ltd. is an international Management Consulting firm, supporting European and Asian clients in the following fields:

- Greater China and Asia Market Advisory
- Market Entry Strategies and Implementation
- Market-/ Feasibility Studies
- Cross-border investments / M&A
- Strategic Partnering / Distribution

For enquiries, you are kindly welcome to visit us at our office or drop us an email.

Contact:

UNITOUCH Services Ltd.
25/F, Central Plaza,
381 Huai Hai Middle Road,
200020 Shanghai, P.R.C.
+86 21 6032 3721

UNITOUCH Services Ltd.
c/o Vaccani, Zweig & Associates
Klausstrasse 43
CH - 8008 Zurich
+41 43 499 20 80

info@unitouchservices.com