

Interpretation of Tariff Headings

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1. Issue

The use of tariff codes to identify goods is not confined to customs laws. Excise, VAT or GST laws and regulations also commonly refer to tariff headings to determine the tax treatment of specific categories of goods. Income tax laws may as well, although more rarely.

The application of tariff headings may give rise to questions of interpretation. Customs officials are usually familiar with such “classification” problems, whereas tax officials working in the sales and consumption tax areas may be far less familiar with them.

For the benefit of the latter, this note provides general background information on customs tariffs and explains the basic rules for the interpretation of the Harmonized System on which these tariffs are commonly based.

2. The Customs tariff

A customs tariff schedule essentially comprises two elements: a goods nomenclature and a list of tariff rates.

Both elements are necessarily linked: in order to determine tariff rates for different categories of goods, those categories must be defined first. This is the purpose of a goods nomenclature. It is important to note, however, that the nomenclature and the tariff rates are different issues.

The goods nomenclature is commonly based on the Harmonized System.

3. The Harmonized System

a. The Harmonized System: the “language of international trade”

The Harmonized System or HS is a goods nomenclature that is developed and maintained by the World Customs Organization (WCO), and is governed by an international convention.¹ Over 190 countries and economies use the HS as a basis for their customs tariffs and for the

¹ The International Convention on the Harmonized Commodity Description and Coding System, available here: http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/Hsconve2.pdf

collection of international trade statistics.² Over 98 % of the merchandise in international trade is classified in terms of the HS, which can thus truly be labeled the “language of international trade”.

b. The structure of the HS

The HS provides a logical structure in which over 1,200 headings are grouped in 96 Chapters, some of which are further divided into sub-Chapters. The Chapters are arranged in 21 Sections. Each heading is identified by a four-digit code, the first two digits indicating the Chapter wherein the heading appears, the latter two indicating the position of the heading in the Chapter. In addition, most of the headings are subdivided into 1-dash subheadings which, where necessary, are further subdivided into 2-dash subheadings, identified by a 6-digit code (HS code).

Thus, for instance, **HS code 2204.21** refers to the fourth heading (2204.21) of Chapter 22 (2204.21), namely the first two-dash subheading (2204.21) of the second one-dash subheading (2204.21). Heading 2204 thus looks as follows:

22.04		Wine of fresh grapes, including fortified wines; grape must other than that of heading 20.09.
	2204.10	- Sparkling wine
		- Other wine; grape must with fermentation prevented or arrested by the addition of alcohol:
	2204.21	-- In containers holding 2 l or less
	2204.29	-- Other
	2204.30	- Other grape must

The full description of subheading 2204.21 is “Other wine; grape must with fermentation prevented or arrested by addition of alcohol; in containers holding 2 l or less”.

c. Obligations under the HS Conventions

The HS Convention requires in particular that HS headings, subheadings and numerical codes be used without addition or modification, and that the General Rules for interpretation are used for its application. Within these limits, textual adaptations are allowed if necessary

² Although there are ‘only’ 127 contracting parties to the HS Convention (situation in February, 2007), many other countries and territories apply the HS without formally being a contracting party to the HS Convention.

to give effect to the HS in domestic law, as well as further subdivisions beyond the level of the six-digit HS codes.³

For instance, it would be allowed to create further subheadings for HS code 2204.21 according to alcoholic strength, but further subdivisions of this subheading may not cover ‘sparkling wines in containers holding 2 l or less’, as these must stay under subheading 2204.10, or further subdivisions added thereto.

d. Application of the HS

The HS is set up as a “closed system”: it classifies *all* traded goods, whether or not existing at the time the HS was established. A number of tools are built into the HS system to accomplish this ambition.

i. **The General Rules for interpretation**

The six General Rules for the interpretation (GRI 1 to 6) are the main tool for the daily application of the HS, and form an integral part of the HS Convention.⁴ The most important GRIs are:

GRI 1 and GRI 6 – Terms of the headings. GRI 1 stipulates that classification is determined according to the terms of the headings and of any relevant Section or Chapter notes. The titles of the Sections, Chapters and sub-Chapters are provided for ease of reference only. If classification cannot be so determined, GRI 2 through GRI 5 must be applied in consequential order. GRI 6 stipulates that GRI 1 through GRI 5 apply *mutatis mutandis* at subheading level, insofar as only subheadings of the same level are comparable.

GRI 2 and GRI 3 – Incomplete, unfinished goods; Unassembled, disassembled goods; Mixtures and combinations of goods. GRI 2 effectively contains two rules. GRI 2(a) applies to incomplete or unfinished and unassembled or disassembled articles, which are classified as the complete or finished article if they have the latter’s *essential character*. GRI 2(b) applies to mixtures or combinations of materials or substances, which must be classified in accordance with the principles of GRI 3. For such goods, or whenever goods are *prima facie* classifiable under two or more headings, GRI 3(a) stipulates that the heading with the *most specific description* applies. Two or more headings referring to only part of the materials, substances or items of a mixture, composite or set are, however, regarded as equally specific, in which case GRI 3(a) cannot be applied and classification must occur according to the material or component that gives them their *essential character*, insofar as

³ See Article 3 of the HS Convention

⁴ The GRI are binding (see sub c. above, and Article 3 of the HS Convention); the GRI are available here: http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/DocumentDB/HS2007/0001E.pdf

this criterion is applicable (GRI 3(b)). When GRI 3(b) cannot be applied, the mixture or combination must be classified under the heading that is *last in numerical order* among the headings that equally merit consideration (GRI 3(c)).

In most cases, however, classification is determined on the basis of GRI 1 (in combination with GRI 6), i.e. according to the terms of the (sub)headings, and any relative Section and Chapter notes.

- **Explanatory Notes, Classification Opinions and Rulings**

The HS Committee that is set up under the HS Convention convenes regularly to update the Explanatory Notes to the HS, to issue Classification Opinions and Rulings on specific goods.⁵ Although these notes, opinions and rulings are not legally binding, they provide useful and authoritative guidance for the application of the HS.⁶

- **Periodic revisions of the Harmonized System**

Despite its comprehensive scope and the aforementioned tools for its application, constant change and evolution in international trade patterns and policy require the HS to be regularly updated.⁷ The HS Committee plays a central role in these 4 to 6-year revision cycles.

The most recent version of the HS was released in February 2007.⁸ The HS Convention allows Contracting parties a two and one-half year implementation period.⁹

⁵ Articles 6 and 7 of the HS Convention

⁶ The HS Committee's most recent amendments to the Explanatory Notes, new opinions and rulings can be found here:
http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/harmonized_system_committee_previous.htm

⁷ The creation of subheadings for ozone depleting substances, precursor chemicals to manufacture illicit drugs, hazardous wastes, endangered species, and narcotics and psychotropic substances are examples in this respect.

⁸ HS 2007 can be accessed here:
http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/DocumentDB/TABLE_OF_CONTENTS_2007.html ; the 2002 edition is available here:
http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/DocumentDB/TABLE%20OF%20CONTENTS.html

⁹ In practice, this period appears too short as it appears that only about half of the contracting parties were able to timely implement previous HS amendments; further information on the HS amendment process is available here: http://www.wcoomd.org/ie/En/Topics_Issues/HarmonizedSystem/hsreviewrevised.PDF

e. Practical example

An example of how the HS applies in practice can be found in the Annex to this note.

4. The customs tariff used for domestic tax purposes

The customs tariff, and the HS on which it is usually based, lay down a goods nomenclature for the purpose of international trade, and its rules of application are in principle confined to that purpose.

However, when customs tariff headings are used without further qualifications for domestic tax purposes such as sales or consumption taxes, its rules of application and interpretation serve well for such national purposes too.¹⁰

Customs tariff classification issues are often highly technical. Customs authorities have developed expert knowledge on these issues, usually centered in a specialized unit that deals with tariff issues. Hence, it is good practice that questions of tariff heading interpretation that arise in the context of domestic taxes also be submitted to the specialized customs unit.

5. Conclusion

While customs tariff codes constitute “the language of international trade”, they are also commonly used for the purpose of domestic taxes such as sales and consumption taxes.

Like all languages, the tariff nomenclature is subject to a number of conventions to ensure that “we understand each other”.

This note sets out the basics of these conventions and how they are applied in practice, both for international and national purposes.

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Annex: The HS in practice: Is this “wine”?

¹⁰ In addition, these rules of application and interpretation help a country to meet its WTO obligations with respect to non-discriminatory internal tax treatment of imported products as compared to like domestic products; See Article III of GATT 1994.

Annex: The HS in practice: Is this “wine”?

What is the proper HS classification of a beverage that is marketed as “wine” but is in fact a mixture of rum and grape juice and has an alcoholic strength of more than 0.5% vol?

Depending on its classification, both the import duty level for the imported product and the excise tax level for both the imported and locally produced product may vary.

The answer to this question requires the following steps:

1) First, Chapter Note 3 to Chapter 22 determines what is an “alcoholic beverage” (i.e. a beverage of an alcohol strength by volume exceeding 0.5% vol), and under which headings alcoholic beverages must be classified, i.e. headings 22.03 to 22.06 and 22.08 as appropriate. Chapter Note 2 indicates how to determine “alcoholic strength by volume”:

Chapter 22

Beverages, spirits and vinegar

Notes.

- 2.- For the purposes of this Chapter and of Chapters 20 and 21, the “alcoholic strength by volume” shall be determined at a temperature of 20 °C.
- 3.- For the purposes of heading 22.02, the term “non-alcoholic beverages” means beverages of an alcoholic strength by volume not exceeding 0.5 % vol. Alcoholic beverages are classified in headings 22.03 to 22.06 or heading 22.08 as appropriate.

2) Heading 22.03 for “beer made of malt” can be disregarded;

3) Heading 22.04 covers inter alia “wine of fresh grapes, including fortified wines”. The Explanatory Notes hereto indicate that the term “wine” (cf. GRI 1) refers to a production process:

(I) Wine of fresh grapes

The wine classified in this heading is the final product of the alcoholic fermentation of the must of fresh grapes.

The heading includes :

- (1) **Ordinary wines** (red, white or *rosé*).
- (2) **Wines fortified with alcohol.**
- (3) **Sparkling wines.** These wines are charged with carbon dioxide, either by conducting the final fermentation in a closed vessel (sparkling wines proper), or by adding the gas artificially after bottling (aerated wines).
- (4) **Dessert wines (sometimes called liqueur wines).** These are rich in alcohol and are generally obtained from must with a high sugar content, only part of which is converted to alcohol by fermentation. In some cases they are fortified by the addition of alcohol, or of concentrated must with added alcohol. Dessert (or liqueur) wines include, *inter alia*, Canary, Cyprus, Lacryma Christi, Madeira, Malaga, Marsala, Port, Malmsey, Samos and Sherry.

The heading **does not cover** :

- (a) Beverages with a basis of wine of **heading 22.05.**
- (b) Medicaments of **heading 30.03 or 30.04.**

This indicates that a mixture of rum and grape juice is not “wine” for HS classification purposes. For the same reason such beverage is not appropriately classified under heading 22.05 for “vermouth and other wine of fresh grapes”.

4) Heading 22.06 covering “other fermented beverages (for example, cider, perry, mead); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included” can also be disregarded on the basis of GRI 1, i.e. the beverage at issue is not a fermented beverage, nor is it a mixture of fermented beverages or a mixture of a fermented beverage and a non-alcoholic beverage.

5) Finally, that leaves heading 22.08, which is structured as follows:

22.08	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 % vol; spirits, liqueurs and other spirituous beverages.
2208.20	- Spirits obtained by distilling grape wine or grape marc
2208.30	- Whiskies
2208.40	- Rum and other spirits obtained by distilling fermented sugar-cane products
2208.50	- Gin and Geneva
2208.60	- Vodka
2208.70	- Liqueurs and cordials
2208.90	- Other

Dealing with a mixture, GRI 3 applies. GRI 3(a), which commands classification under the more specific heading, cannot be applied since 2208.40 (“Rum”), a more specific subheading than subheading 2208.90 (“Other”), only refers to one of the substances in the mixture. GRI 3(b), commanding classification according to the component giving the mixture its essential character, can also not be applied, since only one of the same-level subheadings at issue (“Rum” and “Other”) refers to a component of the mixture. Hence, GRI 3(c) applies, commanding classification under the subheading that occurs last in numerical order, i.e. 2208.90. This is confirmed by the Explanatory Notes to heading 22.08:¹¹

In addition to undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 % vol, the heading includes, *inter alia* :

- (13) Fruit or vegetable juices containing added alcohol and of an alcoholic strength by volume exceeding 0.5 % vol, **other than** products of **heading 22.04**.

6) Conclusion: a beverage that is marketed as “wine” but is in fact a mixture of rum and grape juice and has an alcoholic strength of more than 0.5% vol must be classified under HS code 2208.90.

¹¹ The GRI have legal status and thus take precedence over the Explanatory Notes.