Proper Tariff Classification – A Vital Part of Customs Compliance



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Introduction

Is the Snuggie a blanket or a piece of clothing? And why does it matter?

The Snuggie, a fleece blanket with sleeves, became a cultural phenomenon in 2009, even gaining Oprah Winfrey's "seal of approval" and a segment on Saturday Night Live. But the garment became ensnarled in an international trade dispute over whether it should be classified as a "blanket" or an "article of apparel."

The reason it matters has to do with tariff rates. Every product entering or leaving the United States must be assigned a tariff classification code which, for imports, determines the product's tariff rate.

The Snuggie, manufactured by Allstar Products Group, was found to be "a blanket" rather than "an article of apparel," thereby reducing the rate of import tariff by 6.4 percent.



If, as determined by U.S. Customs and Border Protection (CBP), the Chinese-made Snuggie qualified as a "sleeved polyester fleece wrap," it would be subject to a 14.9 percent import duty. But if, as its manufacturer claimed, the Snuggie actually met the definition of a blanket, the rate would be a significantly lower 8.5 percent.

The dispute was escalated to the U.S. Court of International Trade where, in March 2017, the court ruled the Snuggie was, in fact, a blanket.

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Aside from the strong public interest the case garnered, the outcome is significant for a few reasons:

- It demonstrates the importance of assigning the proper tariff classification to a product entering the United States.
- It highlights the slight variations that can distinguish one classification code from another but with broad tariff implications.
- It proves that U.S. manufacturers can successfully challenge disputes over tariff classifications.

To be sure, assigning the correct tariff classification can be complicated. An importer must select the right classification from a listing of thousands of possible choices. In many cases there may be slight variances between classifications, but one may trigger a significantly higher tariff rate. According to CBP though, there is only one correct tariff classification for each product, and it's up to an importer to ensure the right one is assigned.

"…there is only one correct tariff classification for each product…"

In fact, improper tariff classification is a top reason why shipments are delayed at the border and can be a red flag for CBP agents in identifying potential audit candidates.

The following discussion provides an overview of the U.S. tariff classification system along with information to help businesses understand the importance of proper compliance. Most businesses outsource the customs compliance process to a customs broker or logistics provider, but it's essential to realize that ultimate responsibility remains with the business. At a minimum, an informed manager should have a cursory understanding of the tariff classification process, especially since an improperly assigned code can result in overpayment of duties.

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A Brief History of the International Harmonized System

Imagine a world in which there were no traffic laws. Where everyone pretty much did what he or she wanted, and of course, your vehicle would always have the right of way. It'd be chaotic. Now imagine the same sort of scenario in the world of global trade: where each country had its own standards and rules and there was no compatibility among nations. Chaos, right?

The World Customs Organization, headquartered in Brussels, maintains a globally accepted coding system for 98 percent of the world's trade.



Fortunately, the world's nations recognized the need for uniformity in global trading practices and commissioned the World Customs Organization (WCO) to establish the rules and police enforcement. Located in Brussels, Belgium, the WCO is the self-defined "only international organization with competence in Customs matters and can rightly call itself the voice of the international Customs community."

Central to the WCO's work is development, implementation, and upkeep of a uniform system of codes to identify international trade shipments. The system, known as the Harmonized Description Commodity and Coding System (Harmonized System or HS), includes unique six-digit codes for roughly 200,000 different commodities. The system is used to account for roughly 98 percent of the world's trade merchandise.

Because of HS, a product originating in one country will carry the same identifying code as the same product manufactured in a different country. Without HS, worldwide commerce would be a mishmash of disconnected codes and identifiers.

According to the WCO, the Harmonized System provides a "logical" structure within which more than 1,200 headings are grouped in 96 chapters. The 96 chapters are arranged in 21 sections. Each of the 1,200 headings is identified by a four-digit code, the first two digits of which indicate the chapter wherein the heading appears, while the latter two digits indicate the position of the heading in the chapter.

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Chapter 10 of the international Harmonized System includes classifications for products that fall under the “Cereals” heading.



For example, heading 10.01 (wheat and meslin) is the first heading of chapter 10, which is dedicated to “cereals.”

Most headings are then subdivided into subheadings, which offer further delineation between products:

- HS code 0205.00 means: the fifth heading of chapter 2, which has not been subdivided.
- HS code 0103.10 means: the third heading of chapter 1, first subheading, which has not been further subdivided.
- HS code 0303.11 means: the third heading of chapter 3, which has been subdivided and then further subdivided.

The harmonized codes are updated every five years, most recently in 2017 when 234 changes were implemented. Because the Harmonized System truly is the law of the land, every country must adjust its own import and export practices to ensure it is in sync with HS revisions.

Today more than 200 countries have adopted the HS, which means uniform codes are in place to help minimize disputes and provide clear “rules of the road.” All HS participants utilize the same six-digit HS codes but are permitted to add additional qualifying codes, as a way to capture specific data about the flow of goods crossing their borders.

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Overview of the U.S. Harmonized Tariff Schedule

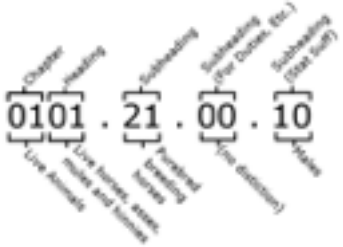
The United States voted to adopt the international Harmonized System through the Omnibus Trade and Competitiveness Act of 1988. That legislation authorized the Harmonized Tariff Schedule of the United States (HTS), which is the listing of all product classifications and tariff rates. The HTS is administered by the International Trade Commission (ITC).

The International Trade Commission administers the Harmonized Tariff Schedule of the United States.

An HTS import code is 10 digits long. The first six digits, the "root" of the code, are based on the international Harmonized System, while the following four digits are unique to the United States.

"The HTS is designed so that each article falls into only one category," the ITC explains in a web-based tutorial. "It is divided into chapters, each of which has a two-digit number. Each product category within the various chapters is designated by 4, 6, 8, or 10 digits. The 4-digit categories are called 'headings,' and the 6-,8-, and 10-digit classifications are called 'subheadings.'"

How to Read a U.S. Harmonized Tariff Number:



Source: Customs Info

Purposes of Classification Codes

The Harmonized Tariff Schedule classifies more than 10,000 separate groups of goods based on their material composition, product name, and/or intended function. In doing so, it provides uniformity among nations for goods entering the United States. But the coding schedule has other purposes as well:

- **Tariff Rates.** Every tariff code has a corresponding rate of duty. Once a tariff code has been assigned to a particular shipment, a shipper will know the duty cost for importing that particular product into a particular country. However, a business must also be aware that the HTS includes "Notes" and "Rules," which describe special conditions that must be met to obtain a particular tariff treatment. Those special conditions could include free trade agreements, content "origination" requirements, or country-specific duty rates.
- **Trade Data.** Government agencies use HS data to track the flow of goods into and out of their country. Based on this information, a country will determine import/export volume. HS data is also used to monitor global trade activity.
- **Free Trade Agreements.** Information about free trade agreement tariff eligibility can be found in the "General Notes" section of the HTS. There are currently 32 General Notes, many of which deal with specific free trade agreement provisions. General Note 12, for example, contains information about the North American Free

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Trade Agreement (NAFTA). NAFTA eliminates duties on all domestically produced products traveling between the U.S., Canada, and Mexico, but it contains very specific guidelines for what is considered "domestically produced." A shipper should be forewarned though that understanding the HTS's "special requirements" can be confusing. The Chapter 12 guidance on NAFTA, for example, runs 648 pages.

- **Anti-Dumping and Countervailing Duties (AD/CVD).** An importer may also use a tariff classification code to gain a general – not definitive – understanding of potential liability for anti-dumping or countervailing duties. The International Trade Administration maintains a listing of all current AD/CVD cases that includes relevant tariff classification codes. For example, a user interested in learning about restrictions on imports of honey from Argentina would find the following:



Import Administration
Honey from Argentina (A-357-812)

Scope Description:

For purposes of this order, the products covered are natural honey, artificial honey containing more than 50 percent natural honey by weight, preparations of natural honey containing more than 50 percent natural honey by weight, and flavored honey. The subject merchandise includes all grades and colors of honey whether in liquid, creamed, comb, cut comb, or chunk form, and whether packaged for retail or in bulk form.
The merchandise subject to this order is currently classifiable under subheadings 0409.00.00, 1702.90, and 2106.90.99 of the Harmonized
Tariff Schedule of the United States (HTSUS). Although the HTSUS subheadings are provided for convenience and U.S. Customs Service (U.S.
Customs) purposes, the Department's written description of the merchandise under investigation is dispositive.

Source: 66 FR 63672
Note that HTSUS numbers are subject to change.

However, as the Customs and Border Protection agency makes clear: "HTS classifications are listed in the scope of AD/CVD orders for convenience only and do not determine whether a product falls under the scope of an AD/CVD order." Instead, only the written description of the scope of the order is dispositive, not the HTS classification.

Ensuring Proper Classification

By CBP's own admission, determining a product's correct classification can be a highly confusing endeavor. Differences between classification categories can be slight but can trigger vastly different tariff obligations. Great care must be exercised, and an importer must avail itself of a number of tools designed to facilitate the process:

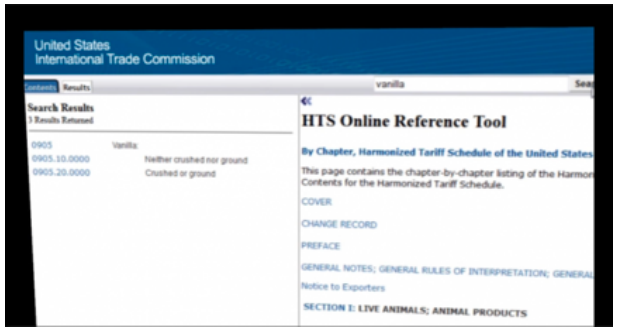
- **HTS General Notes.** The Harmonized Tariff System includes detailed notes and guidance, in the form of "General Rules of Interpretation," that accompany each HTS chapter. One industry expert, John Goodrich, refers to the Rules of Interpretation as the "instructions" for determining the correct classification code. "You search the HTS until you find its specific classification," Goodrich wrote. "You can also eliminate all of the other classifications until you are left with nothing but the parts classification."
- **Online "Tariff Lookup Tools"** are available for both U.S. importers and exporters. The International Trade Commission offers an online database for importers, and the U.S. Census Bureau maintains a Schedule B lookup tool through which Schedule B export codes can be identified. Keep in mind though, a database match does not guarantee a correct classification. As the ITC notes: "Consider the classification of a kitchen paring knife with a ceramic blade. Either a word search or casual browsing through the Tariff Schedule might lead to heading 8211 ('Knives with cutting blades, serrated or not.') However, Chapter 82 Note 1 excludes articles with a blade of ceramic from Chapter 82. The proper classification is in Chapter 69 as an article in ceramics."

There may also be circumstances in which a product might seem to fall within the confines of multiple categories. Screws, for example, could fall under heading

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7318, “screws, bolts, nuts,” but also under “parts and accessories of motor vehicles,” which is heading 8708. A general rule of thumb is to choose the heading that is most specific and that, according to the ITC, describes a product’s “essential character.” In this example, heading 7318 would be most appropriate.

The ITC offers an Online Reference Tool to help importers identify correct HTS codes.



- **Advance Rulings.** To eliminate uncertainty about a product’s tariff classification, a business may request a binding “advance ruling” from CBP. In fact, CBP’s website states: “The U.S. Customs Service strongly urges all parties engaged in transactions relating to the importation of goods into the United States to obtain binding advice from the U.S. Customs Service prior to undertaking that transaction.”

Written guidance from CBP generally comes in the form of a written “ruling letter” that is issued following careful review of a written request by an interested party, usually an importer or exporter. Any request for an advance ruling must be in writing and must contain several pieces of information including:

- A full and complete description of the good in its imported condition
- Component materials
- The good’s principal use in the United States
- The commercial, common, or technical designation
- Illustrative literature, sketches, digital photographs, flow charts, etc
- Chemical analysis, flow charts, Chemical Abstract Registry Number, etc
- Any special invoicing requirements in Section 141.89 of the Customs Regulations
- Any other information that may assist in the classification of the article
- A completed application can either be transmitted electronically via the eRuling template or mailed to CBP’s trade office in New York, NY

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Avoiding Common Classification Errors

A spring 2017 audit by the Canadian government of customs processes found that 20 percent of the goods coming into Canada are misclassified, which during the 2015-16 fiscal year resulted in a $21 million underpayment of duties. On a global basis, one analysis concluded that misclassified shipments result in more than $22 billion in duties owed to government treasuries. Several reasons contribute to the high incidence of misclassified shipments:

- **HTS codes are complicated and difficult to understand.** A cursory look at the U.S. Harmonized System of Tariffs reveals that the document is not for the faint of heart! The language is difficult to follow and at times can seem contradictory. Products are not defined in everyday English. As an example, a shipper trying to determine proper coding for a NAFTA-eligible product will have to navigate the HTS's 170-page "note" that pertains to NAFTA.
- **Tariff classifications can be open to interpretation.** Perhaps not surprisingly, importers looking to minimize tariff obligations sometimes have a difference of opinion with border agents with regard to a product's tariff code assignment. When that happens, a business can challenge CBP and seek a legally binding ruling, as discussed previously.
- **Tariff classifications can change with little notification.** The U.S. government regularly updates the HTS, and the onus is on an importer to be aware of any changes that may affect product classifications. The International Trade Commission issues an updated HTS each year, but supplemental revisions are released throughout the year. It is possible to stay abreast of changes to specific HTS codes through a paid subscription to services offered by any number of third parties. However, this would require dedicating manpower to review the subscription feed and understanding the implications of any HTS rule changes for a particular shipment.
- **Improper training.** While most businesses outsource their compliance management processes to a third party, not every third party dedicates the proper resources to the complicated task of product classification. A *World Customs Journal* report on tariff classification found "many third-party service providers treat HS classification as a clerical or data entry function rather than as one of knowledge management." As a result, many of the people tasked with code assignment do not have the proper training or understanding of the classification process, or the necessary tools at their disposal.
- **Limitations of electronic systems and nuances of the tariff system.** As much as the harmonized system of tariff codes has helped bring uniformity to international trade, the process of code identification remains a highly complex process that frequently necessitates instruction from government trade specialists. This individualized attention does not translate to computerized classification systems, which assign codes based on more generalized assumptions about product attributes.

  Further, the *World Customs Journal* cites the "pervasive use of keyword-based search tools," which can generate long lists of possible codes but are incapable of applying HS classification rules or special rules and notes. For example, a keyword search for a tariff classification for "paper shredder" resulted in hundreds of suggested codes – none of which turned out to be correct.

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"… a misclassified shipment runs the risk of missing out on trade benefits to which it is legally entitled, or of overpaying duties as well as potential fines and legal repercussions…"

Whatever the reason, a misclassified shipment runs the risk of missing out on trade benefits to which it is legally entitled, or of overpaying duties as well as potential fines and legal repercussions. CBP collects almost $57 million annually in fines and penalties and in fact is under pressure from some members of Congress to increase vigilance for potential violations. The bulk of fines result from improper listing of a product's tariff classification and mistakes in valuation for country of origin designation.

Any importer determined to have misclassified goods will (a) be required to pay the duties that were originally owed and (b) face penalties that could amount to several times the value of the merchandise in question.

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Correcting an Improper Tariff Classification Filing

Should an importer realize it has made a mistake in reporting information to CBP, the company can voluntarily disclose the information. By voluntarily reporting the error, an importer can significantly reduce the amount of penalties that would have been imposed had CBP discovered the mistake and initiated an investigation.

According to analysis by Wiley Rein LLP, the most common methods for correcting a CBP filing include:

- **Prior Disclosures.** Importers are required by law to exercise "reasonable care" in reporting accurate information to CBP. When a failure to exercise reasonable care results in an improper tariff classification, a company can voluntarily disclose the information by filing a prior disclosure. In return, CBP will not assess penalties against the importer other than interest on any unpaid duties. However, in situations where an error occurred because of fraud, a prior disclosure will not entirely prevent penalties from being assessed but can result in a reduced penalty amount.

  Important to note is that a prior disclosure must be filed before CBP discovers the error and launches an investigation.

- **Post Entry Amendment (PEA).** PEAs may be filed at any time after goods are entered into the country, up to 20 days prior to the scheduled date of liquidation (usually 314 days after entry). PEAs can be used for a variety of purposes, including to correct errors that resulted in overpayments or underpayments of duties, or to correct inadvertent misclassifications.

  According to the Wiley Rein analysis, a PEA is generally the simplest and most efficient course to follow should the error affect a single entry that has not been liquidated or if the error is clerical in nature.

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Export Codes – Schedule B

The U.S. Census Bureau administers Schedule B export codes, which track volume and categories of U.S. products sold to international markets.

As noted by the Census Bureau, "with over 9,000 codes, the process can seem overwhelming." To facilitate the process, the agency maintains a "Schedule B Search Engine" that can help exporters identify the proper code.

If the Search Engine is not sufficient, an exporter can call the International Trade Help Line at 1-800-549-0595 or email eid.scheduleb@census.gov.

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Conclusion

Although payment of duties is an integral part of the import/export process, there is nothing to gain from paying more duties than necessary. There is much to gain though from taking the time to ensure that products entering the country are charged the least amount of duty possible. A key step in that process is ensuring that products are assigned the proper tariff classification code. But as we have seen, finding the correct code is no easy task.

As CBP's own website warns, "Be aware that the HTS can be very complicated. If you self-classify an item and the classification is incorrect, the mistake can be costly." Customs compliance can be an exceedingly complicated process, and failure to properly complete paperwork could result in denial of benefits, shipment delays, and even fines.

Businesses do not have to take on this confusing responsibility alone. A qualified customs broker or logistics provider can manage the process and ensure that all recordkeeping and compliance mandates are satisfied. But it is essential to take care to partner with a third party who truly has the necessary experience.

A business will need to spend the time to thoroughly research a potential logistics partner and obtain complete answers to pertinent questions:

- What experience does the logistics provider have in transporting shipments across international borders?
- Can you speak with current customers about their experiences?
- How can the logistics provider ensure accurate compliance with all customs regulations, including proper tariff classification?
- What is the provider's success rate for hassle-free, no-delay cross-border shipments?
- What if there is a problem? Will the logistics provider be there to address any issues that may arise should a customs agent question a tariff classification or some other type of customs documentation?

Few businesses can afford the time or expense of having a shipment delayed at the border. This is why a little time spent verifying a potential partner's credentials will go a long way toward ensuring not only that shipments are in full compliance but that they are taking full advantage of all possible duty relief opportunities.

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