

CLASSIFICATION OF GOODS

4.1 CUSTOMS TARIFF

One of the important steps in assessing the amount of duty payable is classification of the goods within the ambit of the Schedule to the Customs Tariff Act. The Indian Customs Tariff is based upon the Harmonized System of Nomenclature

Along the lines of HSN, the customs tariff has a set of Rules of Interpretation of the tariff schedule and General Explanatory notes. The six rules of interpretation and the two general explanatory notes are an integral part of the Schedule. The purpose of inclusion of the rules of interpretation and the general explanatory notes as an integral part of the first schedule is to give clear direction as to how the nomenclature in the schedule is to be interpreted and to give statutory force to the interpretative rules and the general explanatory notes.

The First Schedule comprises of 98 chapters grouped under 21 sections. Most of the sections and chapters are preceded by detailed and exhaustive section and, as the case may be chapter notes. These notes are part of the statute and hence have the legal authority in determining the classification of goods.

4.2 GENERAL EXPLANATORY NOTES

There are two general explanatory notes included in the First Schedule. They are-

- (a) The first note explains the relevance of one dash ["-"] and two dash ["--"]. "-" denotes that the said article or group of articles shall be taken to be sub-classification of the article or group of article covered by the said heading. "--" denotes that that the said article or group of articles shall be taken to be sub-classification of the immediately preceding article or group of articles which has "-".
- (b) The abbreviation "%" in any column of the Schedule in relation to the rate of duty means that the duty shall be computed at the percentage specified on the value of the goods as defined in section 14 of the Customs Act.

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Example

Tariff Item	Description of goods	Units	Rate of duty®	
			Standard	Preferential Areas
(1)	(2)	(3)	(4)	(5)
0801	Coconuts, brazil nuts and cashew nuts, fresh or dried, whether or not shelled or peeled			
	<i>Coconuts:</i>			
0801 11 00	Desiccated	Kg.	70%	60%
0801 19	<i>Other</i>			
0801 19 10	Fresh	Kg.	70%	60%
0801 19 20	Dried	Kg.	70%	60%
0801 19 90	Other	Kg.	70%	60%
	<i>Brazil nuts</i>			
0801 21 00	In shell	Kg.	30%	20%
0801 22 00	Shelled	Kg.	30%	20%
	<i>Cashew nuts</i>			
0801 31 00	In shell	Kg.	30%	Free
0801 32	<i>Shelled:</i>			
0801 32 10	Cashew kernel, broken	Kg.	30%	20%
0801 32 20	Cashew kernel, whole	Kg.	30%	20%
0801 32 90	Other	Kg.	30%	20%

In the above entry, coconut, which is preceded by “-” is classification of the heading Coconuts, Brazil nuts and Cashew nuts, fresh or dried, whether or not Shelled or peeled and Desiccated. “--” is sub-classification of coconut which is preceded by “-”.

The second explanatory note states that the abbreviation “%” stands for specifying that the rate of duty is *ad valorem*. It means the duty shall be computed at the rates specified in the First Schedule on the value of the goods determined in accordance with section 14 of the Customs Act. In the above entry, the standard rates are 35% or as the case may be 25%.

4.3 RULES OF INTERPRETATION OF CUSTOMS TARIFF ACT

4.3.1 Rule 1: The titles of sections, chapters and sub-chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative section or chapter notes and provided such headings or notes do not otherwise require, according to the following provisions:

The above rule lays down the following propositions.

- (a) The titles of sections, chapters and sub-chapters do not have any legal force.
- (b) Terms of headings read with relative section and chapter notes are legally relevant for the purpose of classification.
- (c) The rules of interpretation need not be resorted to when classification is possible on the basis of description in heading, sub-heading, chapter notes and section notes.
- (d) Notes of one chapter or section cannot be applied for interpreting entries in other chapters or sections.

Example: Sub-heading 8422.30 Machinery for filling, closing, sealing or labeling bottles, cans, boxes, bags or other containers; machinery for capsuling bottles, jars, tubes and similar containers; machinery for aerating beverages.

Sub-heading 8472.30 *inter alia* covers machines for closing or sealing opening, closing or sealing mails.

The product in question is a letter closing and sealing machine. Both the headings appear to be relevant for the product in question. However, chapter note 2 to chapter 84 *inter alia* provides that Heading No. 84.22 does not cover *inter alia* office machinery of Heading No. 84.72. Therefore, the product in question will be classified under 8472.30.

4.3.2 Rule 2: (a) Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or dis-assembled.

This rule lays emphasis on the essential character of the goods. Thus goods which have the essential characteristics of finished goods will be classified under the same heading in which the final product has to be classified.

In *TELCO Vs. CC, 1990 (50) ELT 571 (T-B2)*, it was held that synchrocones are components of automobiles. Forgings for synchrocones cannot be treated as parts of automobiles in view of extensive operations to be carried on, on the forgings. It cannot be said that they have the essential characteristics of the finished product. Therefore such forgings are classifiable as such under heading no. 74.03.

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(b) Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of rule 3.

The following propositions are laid out by the above rule.

- (a) Any reference to a material or substance would refer to mixture or combination of that material or substance.
- (b) Any reference to goods containing a particular material or substance would include a reference to goods consisting wholly or partly of such specified material or substance.

Example: The term coffee will include coffee mixed with chicory. Likewise natural rubber will cover a mixture of natural and synthetic rubber.

4.3.3 Rule 3: When by application of Rule 2(b) or for any other reason, goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as follows:

- (a) The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.
- (b) Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified with reference to (a), shall be classified as if they consisted of material which gives them their essential character, in so far as this criterion is applicable.
- (c) When goods cannot be classified by reference to (a) or (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration.

The application of this rule arises when the goods consists of more than one material or substance.

Sub-rule (a) provides that the heading that provides a more specific description should be preferred over the heading that provides a general description.

Example: Product: Steel forks

Competing headings: Heading 82.15 covers spoons, forks, ladles, skimmers, cake-

servers, fish knives etc.

Heading 73.23 covers table, kitchen or other house hold articles and parts thereof of iron or steel

Classification: Heading 82.15 provides a more specific description of the product in question viz steel forks. Therefore, steel forks should be classified under that heading

Sub-rule (b) would apply only if the goods cannot be classified under sub-rule (a). This sub-rule provides that composite goods should be classified on the basis of that material or substance that gives it its essential character.

Example: Product: Lead pencil with an eraser at the back.

Classification: Though the above is a composite goods the essential character is that it is a pencil and the attachment of eraser at the stub is only for the purpose of adding convenience to the user. Therefore, it shall be classified as a pencil and not as an eraser.

If both sub-rules (a) and (b) fails to classify the goods in question, then resort may be had to sub-rule (c), which provides that composite goods shall be classified on the basis of the heading that occurs last in numerical order.

Example: Product: Conveyor belt used in colliery made up of vulcanized rubber in the top layer, textile as the central layer and plastic as the bottom layer.

Competing headings: Heading 40.10 covers conveyor or transmission belting.

Heading 59.10 covers transmission or conveyor belts or belting of textile material, whether or not reinforced with metal or other material.

Classification: Even though both the headings are equally specific, heading 59.10 will prevail over heading 40.10 by virtue of sub-rule (3) of Rule 3.

4.3.4 Rule 4: Goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin.

This rule is popularly referred to as the akin rule. This rule specifies that if the goods cannot be classified in accordance with the earlier rules, they shall be classified under the heading in which the most akin goods are classified.

Example: Product: Plastic films used to filter or remove the glare of the sun light, pasted on car glass windows, **window panes etc.**

Classification: These goods do not find a specific entry in the tariff schedule. However, heading 3925.30 covers Builder's wares of plastic not elsewhere specified – shutters, blinds (including Venetian blinds). Even though the product in question is not a builders ware, they are most akin to plastic blinds and hence it can be classified under 3925.30 heading.

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4.3.5 Rule 5: In addition to the foregoing provisions, the following rules shall apply in respect of goods referred to therein:

- (a) Camera cases, musical instrument cases, gun cases, drawing instrument cases, necklace cases and similar containers, specially shaped or fitted to contain a specific article or a set of articles; suitable for long term use and presented with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This rule does not, however, apply to containers which give the whole its essential character;
- (b) Subject to the provisions of (a) above, packing materials and packing containers presented with the goods therein shall be classified with the goods, if they are of a kind normally used for packing such goods, however this provision does not apply when such packing material or packing containers are clearly suitable of repetitive use.

This rule while recognizing the practice in international trade in the matter of packaging of goods lays down the following propositions;

- (a) Leather or other cases, which are normally supplied along with the goods, however costly they may be, need not be treated separately for the purpose of classification.
- (b) Durable containers capable of repetitive use should be classified separately.
- (c) Containers, which themselves give the essential character to the contents should be classified on their own merits.

4.3.6 Rule 6: For legal purposes, the classification of goods in the sub-headings of a heading shall be determined according to the terms of those sub-headings and any related sub-heading notes and, *mutatis mutandis*, to the above rules, on the understanding that only sub-headings at the same level are comparable. For the purposes of this rule the relative section and chapter notes also apply, unless the context otherwise requires.

The main proposition laid down by this rule is that sub-heading at the same level are comparable. This implies that a sub-heading can be compared only with another sub-heading within the same heading.

4.4 SPECIAL PROVISIONS FOR CLASSIFICATION OF SETS OF ARTICLES AND ACCESSORIES

Section 19 of the Customs Act provides that:

Except as otherwise provided in any law for the time being in force, where goods consist of a set of articles, duty shall be calculated as follows: -

- (a) Articles liable to duty with reference to quantity shall be chargeable to that duty;

- (b) Articles liable to duty with reference to value shall, if they are liable to duty at the same rate, be chargeable to duty at that rate, and if they are liable to duty at different rates, be chargeable to duty at the highest of such rates;
- (c) Articles not liable to duty shall be chargeable to duty at the rate at which articles liable to duty with reference to value are liable under clause (b):

Provided that, -

- (a) Accessories of, and spare parts or maintenance and repairing implements for, any article which satisfy the conditions specified in the rules made in this behalf shall be chargeable at the same rate of duty as that article;
- (b) If the importer produces evidence to the satisfaction of the proper officer regarding the value of any of the articles liable to different rates of duty, such article shall be chargeable to duty separately at the rate applicable to it.

As per the Accessories (Conditions) Rules, 1963, accessories of and spare parts and maintenance or repairing implements for, any article when imported along with that article shall be chargeable at the same rate of duty as that article, if the proper officer is satisfied that in the ordinary course of trade such accessories, parts and implements are compulsorily supplied along with that article and no separate charge is made for such supply and their price being included in the price of the relevant article.

4.5 SOME CASES ON CLASSIFICATION

1. *M/s Sprint RPG India Ltd. Vs. CCE [(2000) 88 ECR 737 (SC)]*

Product imported: In this case, the assessee imported hard disk loaded with computer software. The price paid for 6 such disks was approx. Rs. 68 lacs while the value of the hard disk simpliciter would be roughly be around Rs. 60,000.00.

Rival contentions: Hard disk drive is chargeable to duty under heading 84.71 at a rate of 25% and computer software is chargeable to duty @ 10% [Chapter heading 85.24 read with *Notification No. 59/95 dated 16-03-95*]. The department's view was that the goods is classifiable as computer hard drive loaded with software. The assessee's contention was that what was imported was software loaded on a hard drive disk and hence the rate of duty should be 10%.

Decision : The SC observed that computer software can be brought either on a floppy or magnetic tape or on a hard disk or in a printed form and hence what is imported is software on a container, which is a hard disk. On the facts of the case the court held that the computer software imported by the appellant on a hard disk is assessable at a rate of 10% as per heading 85.24 because what was imported by the appellant was software on a hard disk and it was not hard disk in the grab of software.

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2. *Engee Industrial Services Pvt. Ltd. Vs. UOI [2000 (115) ELT 58, 63 (Kar)]*

Product imported: The assessee had imported a ship for the purpose of breaking.

Rival contentions : In respect of additional duty of customs, the assessee's contention was that the ship is imported for the purpose of breaking and therefore the same is covered under notification no. 167/86-CE dated 01-03-86, which provides for exemption of ferrous scrap arising out of ship breaking. The department's contention was that the imported article was a ship and therefore, the same has to be classified as a ship and not as scrap arising out of ship breaking.

Decision: The court observed that the duty liability arises on the goods imported and not on the products arising from the breaking up of the imported item. Therefore, it was held that the ship should be classified as such and not as scrap arising from the breaking of a ship.

3. *Saurashtra Chemicals Vs. CC [1986 (23) ELT 283]*

This case brings out the importance of section notes and chapter notes in the classification of goods. The tribunal observed that Section Notes and Chapter Notes in the Customs Tariff are a part of the statute and thus are relevant in the matter of classification of goods. These notes sometimes restrict and some times expand the scope of headings. The scheme of the Customs Tariff is to determine the coverage of headings in the light of section notes and chapter notes. These notes, in this sense have an overriding effect on the headings.

Kindly refer the chapter on classification in Section A Excise for other principles on classification.

Self-examination questions

1. How will you determine the customs duty where imported goods consist of articles liable to different rates of duty?
2. What is the purpose of interpretation rules regarding Customs Tariff? Do they form part of the tariff schedule?
3. Explain the 'Akin Rule' of interpretation.
4. Explain rule 3 of the Rules for Interpretation of the Customs Tariff.
5. India Car Co. is manufacturing passenger cars and has entered into a joint venture agreement and collaboration with Videshi Car Co. India Car Co. imported from Videshi Car Co. a shipment of 24 CKD packs (completely knocked down condition) of passenger car components. They filed bill of entry for clearing the goods, which were claimed to be components of motor cars. They also claimed benefit of a notification exempting components, including components of motor cars in semi-knocked down packs and completely knocked down packs.

The adjudicating authority held that the imported components being complete cars in CKD packs had the essential character of the finished product and as such the

consignment were to be treated as motor cars and not components. It was also held that India Car Co. was not entitled to the benefit of the notification as the notification was only for components.

Examine briefly:

- (i) Whether the CKD packs imported into the country could be considered to be motor cars for the purpose of classification and clearance?
- (ii) Whether India Car Co. is entitled to the benefit of exemption notification?

Answer

5. The facts of the given case are similar to the facts of the case of *CC, Bangalore v. Maestro Motors Ltd. – 2004 (174) ELT 289 (SC)* decided by the Apex Court.

- (i) As per interpretative Rule 2(a) of the General Rules of Interpretation of Customs Tariff, any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or dis-assembled. This rule lays emphasis on the essential character of the goods. Thus goods which have the essential characteristics of finished goods will be classified under the same heading in which the final product has to be classified.

In the *Maestro Motors* case, the passenger car components were imported in CKD packs. Thus, what was imported was completely knocked down cars. The components imported had the essential character of a complete car even though presented in unassembled form. Thus, in view of Rule 2(a) of the General Rules of Interpretation of Customs Tariff, the Supreme Court held that the components in CKD packs would be classified as motor car.

Therefore, in case of India Car Co. also, the CKD packs should be classified as cars for the purpose of classification and clearance.

- (ii) In the *Maestro Motors* case, it was observed by the Supreme Court that a notification has to be interpreted in terms of its language. If in the notification, exemption is granted with reference to tariff items in the First Schedule to the Customs Tariff Act, 1975, then the Rules of Interpretation must apply. In that case even for the purposes of the notification, the goods will be classified in the same manner as they are classified for purposes of payment of customs duty. However, where the language of the notification is plain and clear, effect must be given to it.

In this case the notification exempted components, including components of fuel efficient motor cars in semi-knocked down packs and completely knocked down packs. The Apex Court held that for purposes of levy of customs duty, by virtue of interpretative Rule 2(a) of the General Rules of Interpretation of Customs

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Tariff, the components in a completely knocked down pack would be considered to be cars. However, in view of the clear language of the Notification, the components including components in completely knocked down packs would be exempted.

Thus, in view of the abovementioned judgment, the components in CKD packs by India Car Co. would get the exemption under the Notification, even though for purposes of classification and clearance they may be considered to be motor cars.

