

Classification around the world

Case written by

Prof. dr. Albert Veenstra

Rotterdam School of Management

This case

The purpose of this case is to provide insight in the challenges for the global trade management to harmonise trade management policies and practices in a multinational company. This particular case focuses on product classification.

Background

Working in a multinational company is challenging and exciting at the same time. National Chemical Comp (NCC) is such a company. It has a global footprint, which has emerged from a combination of acquisitions and autonomous growth. Through the years, it has seen substantial dynamics in their product portfolio, which has moved from generic chemicals to more and more advanced chemical based products for high tech applications, or in food manufacturing. As in many companies, the roll out of global standards, processes and procedures is catching up with this footprint.

Luuk de Jong is global trade management lead at NCC. His job is to oversee the implementation of global trade management and compliance procedures. His latest challenge is in India. The last five years, there has been a protracted interaction with the Indian Customs and the Indian Courts about the classification of several imported nutritional ingredients.

Nutritional product manufacturing in India

NCC has a global business in nutritional additives. The product portfolio consists of vitamins (soluble in both oil and water), enzymes, minerals, lipids and so on. These products are either liquids or powders, available in relatively small-, or large-scale packages ranging from 1-200 kg, up to 1000 kg or in capsules. These products are sold either to resellers, or in retail channels, where they are marketed as food supplements, early life nutrients or dietary additions. NCC has a significant portfolio of certifications in place to be able to sell these products in markets such as the EU, and the US.

A subsidiary of NCC in India is manufacturing animal and human nutritional products for which ingredients are imported into India. These ingredients include products containing vitamins, enzymes or carotenoids, with other ingredients.

Since about 15 years, these products were classified under the HS code heading 23.09 "Residue and waste from the food industry, preparing animal fodder – preparations of a kind used in animal feed – other". The 'other' category refers to animal feed that is not meant for cats or dogs. Importing was done from other NCC group companies outside of India. Since valuation in inter-company transaction can always be manipulated, the valuation was reviewed by Indian Customs' Special Value Branch. This SVB confirmed the valuation principles of NCC.

However, the classification of the goods was challenged by the Central Intelligence Unit of Indian Customs. The general claim was that these goods, declared under chapter 23.09 should have been classified under HS code chapter 29.36 (Organic Chemicals – provitamins and vitamins (..) – other, including natural concentrates). Chapter 29.3690 comes with duty rates of 10% basic duty, 18% countervailing duty (CVD) and 10% special countervailing duty. Chapter 23.0990 has 30%, 0% and 10% for these three duty rates, respectively. For foreign companies, the CVD is generally applicable.

After this challenge, other products groups were also challenged. The Special Intelligence and Investigation Branch claimed that some of the enzyme related products should be classified under HS chapter 35.07 instead of 23.09. Chapter 35.0790 has 10%, 18% and 10% for the three duty rates, respectively.

As a result of this, several years of discussion, claims and counterclaims and creation of test reports followed. Part of the discussion ensued around the issue if the products are feed premixes/additives, or actually pure vitamins for use in medicaments. The test reports from the Indian Customs test lab seemed to provide proof for the latter. In addition, based on a court case, Customs claimed that products containing large amounts of vitamins could never be classified in HS chapter 23.09. On the other hand, various requests from NCC, for instance to cross examine the chemical expert of Indian Customs, were neither accepted nor denied.

NCC therefore proceeded to write a brief that underpinned the classification decision for chapter 23.09 for an array of imported products. This brief referred to a number of court cases and explanations of Indian governmental bodies. In addition, it greatly emphasized the use of the products for applications in animal feed products.

Global trade management

NCC is developing its global trade management approach. Part of this approach is a global decision-making process on classification of products. As part of this effort, early on in the dispute, an NCC tax official had already analysed the situation, made some worst-case cost and penalty calculations, and noted that the classification of the products at import into India was not in line with the global NCC policy.

This policy was: classify the products as either vitamins (HS 29), enzymes (HS 35), and not HS 21 (food) or HS 23 (feed) since the duty rates for the latter are generally higher in most countries in the world. India, however, is an exception to this 'rule'. Therefore, since 2010, these products are classified in India under HS 23.

In addition, this discrepancy between the NCC local Indian and global approaches was noticed by the Indian Customs Central Intelligence Unit, which did not do much good for the legal position of NCC in India. The NCC strategy now consisted of three parts: for some products the classification was changed, for some other products, the classification was already deemed (largely) correct, and for some products, the classification decision of Indian Customs was disputed. For this last category, higher duty rates were paid, but under protest.

As an alternative for reclassifying the products for India, the global classification policy could also be assessed. The memo of the aforementioned tax official laid out that the financial exposure of changing the classification of nutritional components would be an order of magnitude larger than the financial exposure in India. Nevertheless, the classification policy needed to be harmonized to avoid reputational damage of the company.

The situation is further complicated by a court case for a competitor, where the classification of some similar products was stated to be HS 23.09, in contrast with their own global policy. The competitor has explicitly argued for a deviation from their own global policy, but backs this up, among others, with a binding tariff decision for the US. This deviation has apparently been accepted by Indian Customs.

Luuk de Jong had to make up his mind how to handle this situation. For a multinational company, a global policy should be leading for operations and activities in individual countries. However, the market situation in India might be sufficiently specific to allow a deviation of the global policy. But what were the criteria to determine this? And how could a policy be set that would avoid the claim from any Customs Agency that NCC was trying to find the lowest possible duty rate to apply to its products, regardless of the business reality?

Questions for discussion

1. How do you think did the discrepancy between the classification in India and the global policy of some of the nutritional products and ingredients come about?
2. Could there be reasons why a deviation of the global classification policy in India could be justified?
3. What is the purpose and merit of a global classification policy for a company such as NCC?
4. What would be the main elements of a global product classification policy?
5. Is it desirable to allow local deviations from the global policy?
6. What would your strategy be to resolve the classification challenge in India?

ANNEX

A sample product datasheet

Dry Vitamin K1 5%

	1g contains
Vitamin K1	50 mg
Acacia Gum	500 mg
Sucrose	50 mg

Vitamin K1 is the molecule Phytonadione, or $C_{31}H_{46}O_2$. Acacia Gum is a common 'carrier' of active ingredients. Sucrose is a sugar form.

Dry Vitamin K1 5% SD

Product code: 0434922

Description

Dry Vitamin K1 5% SD is a powder. The individual particles contain Vitamin K₁ finely dispersed in a matrix of Acacia and Sugar.

Product identification

Product code: 04 3492 2

Chemical names: 2-methyl-3-[(7*RS*,11*RS*)-3,7,11,15-tetramethyl-2-hexadecenyl]-1,4-naphthoquinone; 2-methyl-3-[(7*RS*,11*RS*)-3,7,11,15-tetramethyl-2-hexadecenyl]-naphthalene-1,4-dione; 2-methyl-3-phytyl-1,4-naphthoquinone

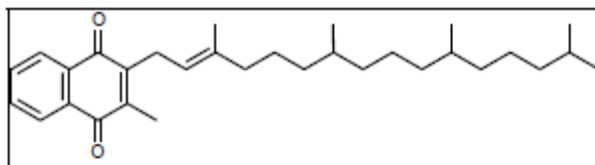
Synonyms: phytomenadione (all-*rac*); phytonadione (all-*rac*); α -phyloquinone (all-*rac*); vitamin K (all-*rac*)

CAS No.: 81818-54-4

EINECS No.: 279-833-9

Empirical formula: C₃₁H₄₆O₂

Molecular mass: 450.68 g/mol



Specifications

Appearance:	powder
Colour:	off-white to light yellow
Fineness (US standard sieves):	
• through sieve No. 80	min. 90 %
Identity for vitamin K ₁ :	corresponds
Loss on drying:	max. 5 %
Vitamin K ₁ content:	min. 5.0 %
Microbiological purity:	
• Total aerobic microbial count	max. 10 ³ CFU/g
• Total combined yeast/moulds count	max. 10 ² CFU/g
• Enterobacteria	< 10 CFU/g
• Escherichia coli	negative in 10 g

Dry Vitamin K1 5% SD

Product code: 0434922

- | | |
|--------------------------|------------------|
| • Salmonella spp. | negative in 25 g |
| • Staphylococcus aureus | negative in 10 g |
| • Pseudomonas aeruginosa | negative in 10 g |

Stability and storage

Dry Vitamin K1 5% SD is stable to air, but decomposes on exposure to sunlight. The product may be stored for 36 months from the date of manufacture in the unopened original container and at a temperature below 15°C. The 'best use before' date is printed on the label.

Uses

For dry food and pharmaceutical preparations and suitable for use in foods intended for infants and young children.

Compendial compliance

Vitamin K1 used in this formulation meets all requirements of the USP, FCC and Ph. Eur. when tested according to these compendia.

Safety

This product is safe for the intended use. Avoid ingestion, inhalation of dust or direct contact by applying suitable protective measures and personal hygiene.