

Implementing Harmonized Commodity Description and Coding System: A Primer



WHITE PAPER

Broadly, the outlook for global trade for the remainder of 2017 and beginning of 2018 continues to be unpredictable as companies that do business globally navigate through the haze of protectionist threats — seen primarily in Brexit, the re-negotiation of NAFTA and the foreign policy agenda of the United States.

Companies cannot directly control the policies that shape their industries at a global level — so maximizing any opportunity to streamline trade operations is paramount in today's unpredictable trade climate. Automation is key. It creates important efficiencies for trade teams.

Through research, it's clear that classification, a fundamental requirement for moving products across borders, is a significant hurdle for virtually all global trade departments. In 2016, 91% of respondents to the Thomson Reuters and KPMG LLC 2016 Annual Global Trade Survey reported challenges when managing product classification. This statistic reinforces that while trade and supply chain departments worldwide are trying to keep up with the pace of change, the majority are still missing the systems and processes they need to thrive in today's unpredictable and challenging trade environment.

Classification needs are ongoing: the sheer volume of products to classify, coupled with the continuous agency or regulatory changes regarding classification, make it a time-consuming and error-prone activity for trade compliance departments. In addition, disparate systems and countless spreadsheets make it difficult for many trade compliance departments to share product information throughout their organization, causing inconsistent classifications and disparity in record keeping locations.

This is a structural barrier to the benefits associated with trade. Our survey also found that too many trade departments are foregoing opportunities to reduce duties under free trade agreements. The lack of automation, plus the difficulty of performing classifications manually, may contribute materially to incomplete Free Trade Agreements (FTA) utilization.

Source of classification complexity

One source of this challenge is that the codes used by countries to classify products vary greatly from one country to the next. As new products develop and new supply chain linkages form, this challenge is only growing in complexity.



In most cases, a country does not adopt the latest HS amendments due to lack of funding or expertise. There may be no sense of urgency or consensus, and any goal to streamline trade regulation becomes secondary to other pressures.

The lack of uniform adoption of a common version of the Harmonized Commodity Description and Coding System (HS) among trading nations is a substantial concern for trade. Since its inception in 1998, the HS has undergone five updates to keep up with changes in the products that are traded worldwide. According to the World Customs Organization (WCO), however, only 83 of its 155 members — just over half — had either implemented or committed to implement the latest HS amendments as of March 1, 2017¹.

There is no meaningful guidance on when, or if, the remaining 72 WCO member countries will harmonize classification codes with their counterparts.

For companies with global supply chains, this presents a particular challenge: the same product or component could be classified differently depending on where it is being shipped simply because of the HS version in use.

CODiE award-winning Checkpoint Global HS, powered by 3CE, eliminates the need to track the status of HS versions by country. Global HS classifies your products and provides the duty-rates from the HS version applicable to the country of destination of your products.

¹ http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/nomenclature/overview/hs-contracting-parties/positions-of-cp/situation_hs.pdf?la=en

In addition, although customs authorities often recommend that importers consult with a customs broker or a legal authority when classifying goods, the responsibility to classify goods remains.

The operational impact of non-harmonized classification codes

The general complexities of classification can have specific, operational implications for a MNC. A deep dive into the Harmonized Tariff Schedule (HTS) of the United States, the 10-digit import classification specific to that country, can provide a useful illustration of classification complexity.

Successfully qualifying goods for free trade agreements and origin determination depend on having the right HTS code cited. Using the wrong code can result in falsely declaring FTA preference, leading to loss of duty-free treatment and potential penalties — without a way, in many cases, to recoup the duty loss from customers because the goods have already been sold. The bottom line is that any time the code changes, product eligibility for duty-free treatment is put at risk — and so is your company's bottom line.

HTS codes changed recently

What happened next was puzzling in its complexity. Each HTS release includes a “change record” that allows companies to quickly identify whether the changes affect their products. Typically, HTS updates affect only a small number of products, but companies must still evaluate all products to determine if the HTS or FTA eligibility is affected.

The tariff change rules (TCR) that establish an item's eligibility for FTA preference are not always updated to coincide with the changes in the HTS. The TCR states the applicability of the rule based on the HTS code. Unfortunately, the HTS code change affects applicability of a rule, in some instances.

For example, in 2016 a product was classified as 8460.21.00. Under the North American Free Trade Agreement (NAFTA), the TCR rule applied is:

A change to subheading 8460.21 from any other heading, except from more than one of the following: (A) subheadings 8413.50 through 8413.60, (B) tariff items 8466.93.15, 8466.93.30, 8466.93.47 or 8466.93.53, (C) subheadings 8501.32 or 8501.52, (D) subheading 8537.10.

In 2017, the HTS expanded that subheading by splitting it into three — 8460.22, 8460.23 and 8460.24 — but the NAFTA rule was not updated in a timely manner and, long after the original change, still referenced the non-existent HTS code, 8460.21. In this example, there was no rule that applied to 8460.22, 8460.23 or 8460.24 because the next rule referred to 8460.29:

A change to subheading 8460.29 from any other heading, except from tariff items 8466.93.15, 8466.93.30, 8466.93.47 or 8466.93.53, or subheadings 8501.32 or 8501.52

If the HTS change takes the product outside the applicability range of a rule, Customs guides industries to classify the product using the last year that the product had a corresponding TCR.

In the example above, a trade team would have to have a way to keep old classifications of a product. Most classification tracking processes only account for the most recent HTS classification but this example shows us that classification databases need to also manage 2016 classifications, 2012 classifications, and maybe all the way back to 2007 classifications if the TCRs have not been updated. However, the NAFTA certificate should show the current 2017 classification, along with a notation in block 5 that the 2016 classification was used for qualification purposes, such as:

(Origination analysis performed using HTSUS 8460.21 (2016) since no TCR for item number 8460.23 in 2017 HTSUS.)

This process would need to be handled manually, with both speed and accuracy, to reduce duty on that one single product.

The following table provided by Customs shows the versions of HTS used by each free trade agreement in which the United States is involved. Most of the U.S. FTA Product-Specific Rules (PSRs) have been updated to the 2007 HTS, but only two have been updated to the 2012 HTS and none have been updated to take into account the 2017 HTS codes.

Free Trade Agreement	PSRs Updated to 2007 HTSUS	PSRs Updated to 2012 HTSUS	PSRs Updated to 2017 HTSUS
1. Australia FTA	Yes	No	No
2. Bahrain FTA	Yes	No	No
3. CAFTA-DR	No	No	No
4. Chile FTA	Yes	Yes	No
5. Colombia TPA	No	No	No
6. Israel FTA (QIZs)	No product specific rules	No product specific rules	No product specific rules
7. Jordan FTA	No product specific rules	No product specific rules	No product specific rules
8. Korea FTA	Yes	Yes	No
9. Morocco FTA	No	No	No
10. NAFTA	Yes	No	No
11. Oman FTA	No	No	No
12. Panama TPA	No	No	No
13. Peru TPA	No	No	No
14. Singapore FTA	Yes	No	No

The process of identifying HTS changes and adapting the trade classification process to accommodate them is one case study to illustrate how data management tools and automation are crucial components of a trade compliance program.

The ONESOURCE™ Global Trade Classifier module automatically identifies the 2017 changes and creates a workflow for approving the classification changes. Concurrently, the ONESOURCE Global Trade for FTA module can produce a report that shows when an HTS code is no longer valid or missing. By housing more than just the most recent HTS code, it can also adjust the applicable rule based on the last applicable HTS and automatically document this correlation on the NAFTA certificate.

These automated data management programs notify users to re-evaluate HTS classifications and FTA qualifications and ensure continued compliance without additional work for the compliance team.

The need for automation

Manual processes — such as import and export documentation and administration related to classification — tie up resource in trade departments that aspire to work on the many strategic areas of trade that deliver value to the organization. Few companies have automated trade-related documentation and licensing, customs broker management and import classification, which are three of the top four tasks that occupy the time and resources of trade specialists, according to data from the Thomson Reuters 2016 Global Trade Survey.

Related to this, free trade agreement usage continues to be low, with just 23% of respondents to the 2016 survey saying their companies are fully utilizing all FTAs available in their country and applicable to their products. This is a global issue, with all regions attributing underutilization to the difficulty of record-keeping and tracking supplier information.

Accurate product classification is a fundamental requirement for moving products across borders. It's also one of the most challenging trade activities cited by trade professionals.

Next steps

When evaluating a classification workflow tool or process, trade specialists and those who they report to should consider the following:

- ✓ Is the tool updated to reflect the latest nomenclature?
- ✓ Does the tool or process adjust for differences in the underlying HS nomenclature, country by country?
- ✓ Does the tool quickly help a user identify inconsistencies in the classification decisions or differences in classifications between countries?
- ✓ Does the tool alert the user to changes in the harmonized tariff schedules for individual countries and the potential impact on previously classified products?
- ✓ Does the tool or process create an audit trail to support the classifications?

When evaluating an FTA solution, trade specialists and those who they report to should consider the following:

- ✓ Does the FTA solution have an audit trail and audit process to identify potential problems with qualification?
- ✓ Does the FTA qualification process alert the user when changes — such as HTS codes, rules and expiration dates — may affect their eligibility?
- ✓ Can the FTA solution easily adapt to changes in HTS codes and PSR rules?
- ✓ Does the FTA qualification process save time and add value to the user's suppliers?

About Thomson Reuters Trade Solutions

ONESOURCE Global Trade Classifier

Thomson Reuters ONESOURCE Global Trade Classifier is a workflow tool that reduces the time spent on classification while minimizing errors. You can quickly classify products through a batch classification process, access the harmonized tariff schedules for more than 170 countries, create an audit trail for your classification decisions and set up alerts for regulatory changes that might impact your classification decisions. Our classification engine supports countries that base their harmonized tariff schedules on the 2002 through 2017 HS nomenclature.

ONESOURCE Global Trade for FTA

Thomson Reuters ONESOURCE Global Trade for Free Trade Agreements can help companies identify opportunities to qualify their goods under FTA-specific rules of origin or reduce supply chain costs by taking advantage of Free Trade Agreements (FTAs). It further reduces risks in complying with FTA guidelines by streamlining logistical processes, eliminating manual work and ensuring adherence to the latest regulatory changes. Using ONESOURCE Global Trade for FTA gives you the confidence to act boldly to strengthen your competitive advantage in a complex world.

Checkpoint Trade

Thomson Reuters Checkpoint is the industry leader providing intelligent information to trade professionals — including expert research, guidance, technology, tools, training and news. Checkpoint is relied on by trade professionals to understand complex information, make informed decisions and use knowledge more efficiently. Now featuring award winning Global HS, a classification engine and country-to-country comparison tool with HS code and duty rate info for 170+ countries (as well as global VAT, excise tax, ADD/CVD info, and more), and PGA Analyzer (a searchable repository of documents, news and forms for dozens of Other Government Agencies and Partner Government Agencies).

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