HSN – Meaning and classification

Letter Of Credit – Type & Difference

India’s Foreign Trade Agreements

HSN – Meaning & Implications

- The acronym HSN stands for **Harmonised System of Nomenclature**.
- The Harmonised Commodity Description and Coding System generally referred to as "Harmonised System" or simply "HS" is a multipurpose international product nomenclature developed by the World Customs Organization (WCO).
- It is an internationally standardized system of names and numbers to classify traded products.
- It has about 5,000 commodity groups, each identified by a six-digit code, arranged in a legal and logical structure.

- It is supported by well-defined rules to achieve uniform classification.

- HSN Codes for each commodity is accepted by most of the countries.

- The HSN number remains same for almost all goods globally except for few goods

- However, HSN number used in some of the countries varies little, based on the nature of goods classified.

Usage of HSN

It is also extensively used by governments, international organizations and the private sector for many other purposes such as :

- internal taxes,
- trade policies,
- monitoring of controlled goods,
- rules of origin,
- freight tariffs,
- transport statistics,
- price monitoring,
- quota controls,
- compilation of national accounts, and
- economic research and analysis.

HSN – Indian Context (Customs Act Tariff Act)

The Government of India, Mof, DoR, CBIC issued Letter vide D.O.F.No.524/11/2021-STO(TU) dated December 20, 2021 to notify HSN amendments in Custom Tariff Act, 1975 from January 01, 2022 so as to align the same with HS 2022.

The new (seventh) edition of the Harmonized System (HS) nomenclature, HS-2022, shall come into force from January 01, 2022.

This edition has introduced significant changes to the Harmonized System with a total of 351 amendments at the six-digit level, covering a wide range of goods moving across borders.

Interlinking between HSN used in Customs & GST Act

Notification of Rate of Tax Under GST :

The Central government on recommendation of GST council has notified rate of Integrated tax payable on goods vide notification no. 01/2017 – Integrated tax (rate) dated 28/06/2017.

It may be noted that notifications regarding central tax (CGST) issued by Central govt and notification regarding state tax (SGST) issued by respective State Govt have identical provisions.

the schedules in notifications issued by respective government as discussed above, has reference to chapter, heading, sub heading and tariff items.

Particulars	Description	Meaning	Example
Section	Broad category	The Custom Tariff Act 1975 is divided into 21 sections	Textile & Textile Articles
Chapter	Specific descripti	The 21 sections are further divided into 98 Chapters.	Articles of apparel and clothing accessories, knitted or crocheted
Heading	Next 2 Digits	Each chapter is further divided into various "headings" accompanied by a four digit number.	Men's or boy's shirts, knitted or crocheted
Sub-heading	Next 2 Digits	Each heading is further divided into various "sub headings" accompanied by a six digit number, thus first 6 digits of an 8 digit HSN codes denote the sub heading under which it falls.	Of Cotton
Tariff heading /item	Next 2 Digits	: Each Sub heading is further divided into various "tariff items" accompanied by a eight digit number, thus all 8 digits of HSN code denotes the tariff item.	Shirts, hand crocheted

Classification of Goods - Why Important

Classification of Goods under Customs Act is essential to decide the rate of duty.

The Classification of goods would continue to be very important unless all goods attract the same rate of duty

Correct Classification of goods has an important bearing on a number of other connected substantive and procedural importance.

The interpretation of the Tariff schedule is strictly governed by six "Interpretative Rules" incorporated in First Schedule itself.

These rules are scientific set of principles which will be applied while arriving at classification of a particular product.

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 subsequent rules.

Example: If we were importing Christmas tree candles, it would seem logical to classify them with Classification Number 9505 : "Other, articles for Christmas festivities".

However, when reading the Notes to Chapter 95, it clearly states this Chapter **does not cover Christmas tree candles**.

In fact, we must classify them with the Classification Number 3406: Candles, tapers and the like.

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.

Example: An automobile missing only its wheels would be classified the same as if it were complete.

Rule 2 : (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.

Example :
If we were importing di-calcium citrate, the Tariff does not specifically state this compound. However, it is a compound containing more than one material and its essential character is that of a salt of citric acid.

Therefore, di-calcium citrate qualifies as Classification Number 2918: “Salts and esters of citric acid, Other”.

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.

Example: Mint tea is not stated specifically, as a product, in the Tariff.
Although the product descriptions available are mint and tea, the importer must classify mint tea under the appropriate tea Heading because it provides the most specific product description and mint is only the flavor of the tea.

(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 by reference to 3(a), shall be classified as if they consisted of the material or component which gives them **their essential character**, insofar as this criterion is applicable.

Example: An importer bringing in "liquor gift sets" (that include the bottle of liquor and glasses) must classify the goods under the appropriate liquor Heading. The essential character of the item is the liquor itself and not the glasses contained within the set.

(c) When goods cannot be classified by reference to 3(a) or 3(b), they shall be classified under the heading **which occurs last** in numerical order among those which equally merit consideration

Example: A gift set which includes socks (Heading number 6115) and ties (Heading number 6117) cannot be classified by the previous rule since neither item gives the gift set its essential character. The gift set must be classified under the Heading number for ties which is the Heading that occurs last in numerical order.

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.

Explanation: This is a "last resort" rule, most often used with new products.

Rule 5: In addition to the foregoing provisions, the following Rules shall apply in respect of the 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 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 Rule 5 (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 materials or packing containers are clearly suitable for repetitive use.

Example: Rule 5 (a) would apply to flute cases because flutes are normally sold with their cases (due to their specific shape) and are intended for long term use.

Explanation: Rule 5 (b) deals with other types of containers and packing materials.

These should be classified with the goods they contain if they are of a kind normally used for packing such goods and are not suitable for repetitive use.

Rule 6: For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related Subheading Notes

and

mutatis mutandis, to the above Rules, on the understanding that only subheadings at the same level are comparable.

For the purpose of this Rule the relative Section and Chapter Notes also apply, unless the context otherwise requires.

Some Case Studies

In 'Commissioner of Central Excise, Chennai V. Toyota Tsusho Private Limited' – 2015 (12) TMI 480 - SUPREME COURT

the respondent imported 'beef leather cut pieces set TFC 235 set' which was classified under Customs Tariff Heading 4115 20 90 for which the exemption was claimed under Notification No. 21/2002.

The Department, after examining the goods, took the view that the aforesaid goods were classifiable under Chapter 42 viz., 4205 00 90 which attracted duty @ 15% + CVD 16% + EC 2% and levied a duty of ₹ 22,86,812/-. The Commissioner (Appeals) upheld the classification of the Revenue.

The Tribunal accepted the appeal of the assessee and classified the goods under Chapter Heading 4115 20 90 as 'beef leather cut pieces set TCF 235 set'.

The Supreme Court was, during the course of arguments, shown two other Chapter Headings 87, 97 and 94.

The Supreme Court felt that it would have been more appropriate for the Tribunal to look into the aforesaid Chapter entries as a whole and then come to a definite conclusion, in the light of the definition of the goods involved as to which the most appropriate entry under which they fall.

In 'Samsung India Electronics Private Limited V. Commissioner of Customs, Noida' – 2015 (10) TMI 2258 - CESTAT NEW DELHI

the Tribunal considered the issue to be decided is that whether Liquid Crystal Devices (LCDs) is classifiable under Tariff item 9013 80 10 or 8529 9090 of Customs Tariff Act, 1975.

The goods imported include components comprising driver, circuit, backlight, unit and inverter etc., which according to the Revenue are parts of LCD TVs covered under Heading 8529.

The Tribunal held that the said components are also devices in their own right, individually and in combination, and as liquid crystal panel is one of the components, impugned goods are covered under term 'LCDs'.

LCDs is specifically mentioned in Head 9013 by name and Tariff item 9013 80 10 exclusively covers only LCDs. In contrast, the description in Heading 8529 'as parts suitable for use solely or principally with apparatus of Headings 8525 to 8528 is general in nature.

Section Note 2 (b) of Sec. XVI of Customs Tariff Schedule, relied on by Revenue covered only goods under Chapters 84 and 85 and not applicable to Chapter 90 as per Note (1)(m) of Sec. XVI.

In 'Binani Cements Limited V. Union of India' – 2013 (7) TMI 798 - GUJARAT HIGH COURT

The High Court held that the Court does not encourage litigation at the stage of the issue of show cause notice as noticee would have sufficient opportunity to meet with all obligations and produce such material on record as may be required to refute the same. Therefore the instant petition challenging the show cause notice issued questioning classification of coal by the petitioner was rejected by the High Court.

The High Court further held that when several questions of fact as well as law would arise i.e., classification between steam and bituminous coal, properties of coal imposed by petitioner etc., which cannot be judged without adjudication by departmental authorities.

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In ‘AGS Transact Technologies Limited V. Commissioner of Customs (Import), Nhava Sehva’ – 2013 (5) TMI 808 - CESTAT MUMBAI

The appellants imported cash dispenser declaring it as ATM and availed the benefit of exemption under Notification No. 25/2005-Cus, dated 01.03.2005. The Revenue classified the goods under Heading 8472 90 30 denying the exemption.

The Revenue contended that machines with facility to receive or accept cash is not ATM.

The Tribunal held that the classification of goods is to be determined by commercial identity test and not by functional test.

The Tribunal found that Procash 1500Xe not only dispense cash but also perform the other bank transactions like balance enquiry, cheque book request, statement request, pin change, fund transfer, mini statement etc., but not having the facility of the cash/cheque deposit.

The same shall be construed as ATM in the absence of clear findings.

The Tribunal remanded the matter to the original authority.

In ‘Commissioner of Customs, New Delhi V. Capital business systems Limited’ – 2011 (3) TMI 1570 - CESTAT NEW DELHI

the matter involved in this case is the classification of a printer imported by the respondent. As per the technical specifications the printer can print on paper, synthetics, labels, foils, thermostatic stocks.

The Assistant Commissioner classified the goods under 84436090.

The Commissioner (Appeals) classified under 84716026 -

The Revenue objected to this classification for the reason that it is huge in size as compared to ordinary printers used along with computer and for the reason that it can print material other than paper.

This machine does not make use of printing type, blocks, plates, cylinders and other printing components of Heading 8442. So the impugned order is clearly classifiable under Tariff item 84716026.

LETTER OF CREDIT :

A letter of credit is an important financial tool in trade transactions.

Trades use the LC to facilitate payments and transactions in both domestic and international markets.

A bank or a financial institution acts as a third party between the buyer and the seller and assures the payment of funds on completion of certain obligations.

A letter of credit is issued against a pledge of securities or cash.

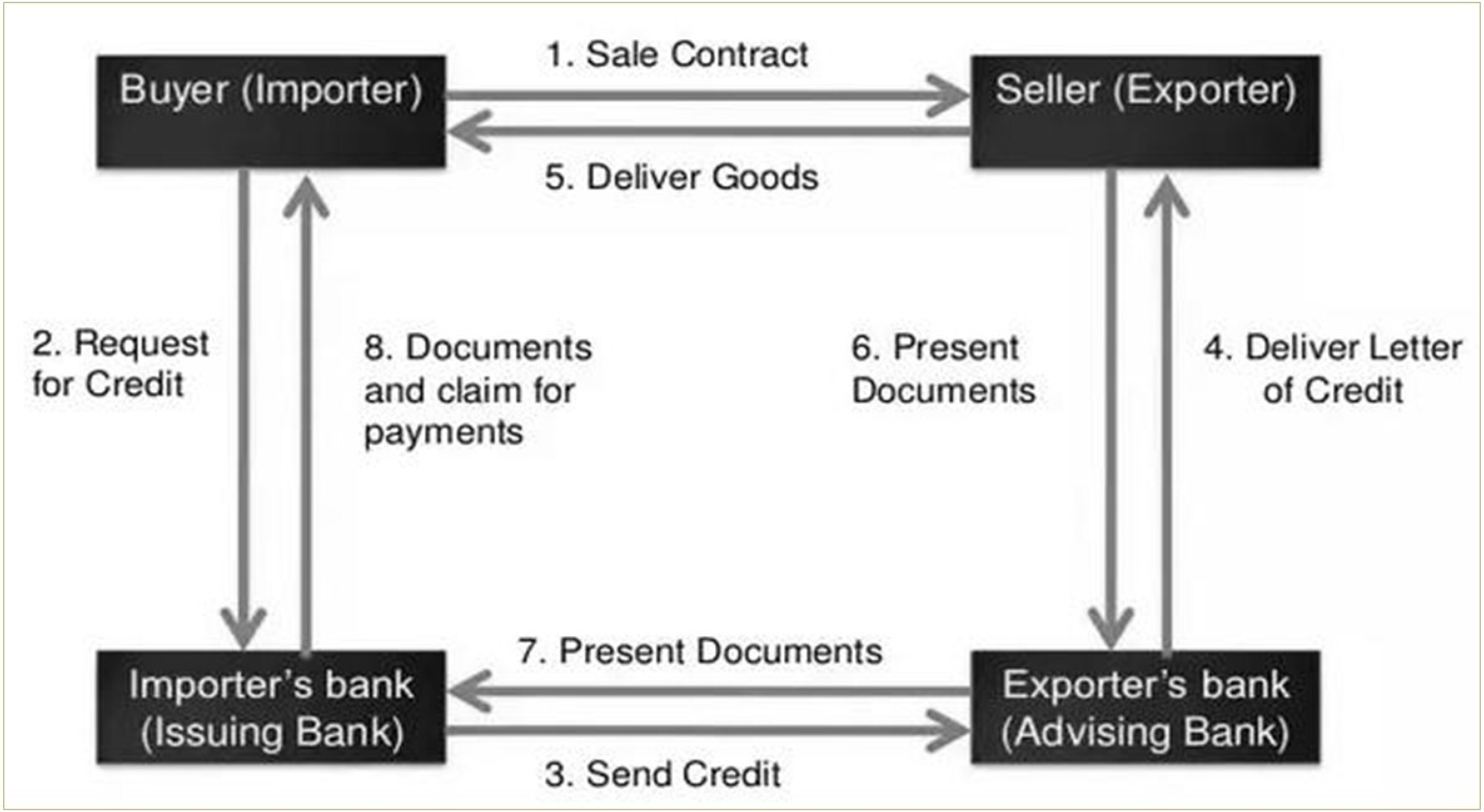
Banks typically collect a fee, ie, a percentage of the size/amount of the letter of credit.

If buyers default, the bank pays sellers on their behalf. Therefore, an LC is used for mitigating credit risks.

The ‘International Chamber of Commerce Uniform Customs and Practice for Documentary Credits’ oversees letters of credit used in international transactions.

Sellers get paid only after providing all those documents.

The issuing bank acquires the amount from the buyer. Subsequently, the amount is released in favor of the seller, beneficiary, or the beneficiary’s negotiating bank.


1. Sale Contract
Buyer (Importer)
Seller (Exporter)
5. Deliver Goods
2. Request for Credit
8. Documents and claim for payments
6. Present Documents
4. Deliver Letter of Credit
7. Present Documents
Importer's bank (Issuing Bank)
Exporter's bank (Advising Bank)
3. Send Credit

Types OF LC

Commercial LC

The commercial LC is the most basic form of an LC. It is a standard LC, also called a documentary credit.

In a commercial LC, the importer issues the LC with the exporter as the beneficiary.

The same LC becomes an export or import LC depending on who uses it. The exporter will term it as an exporter letter of credit, whereas an importer will term it as an importer letter of credit.

Transferable LC

A letter of credit that allows a beneficiary to further transfer all or a part of the payment to another supplier in the chain or any other beneficiary is a transferable LC.

Un-transferable LC

An un-transferable letter of credit doesn’t allow the transfer of money to any third parties. The beneficiary is the only recipient of the money and cannot further use the letter of credit to pay anyone.

Revocable LC

A revocable LC is an LC that issuing bank or the buyer can alter at any time without any notification to the seller/beneficiary. Such types of letters are not in use frequently as the beneficiary is not provided any protection.

Irrevocable LC

It is an LC that does not allow the issuing bank to make any changes without the approval of all the parties.

Standby LC

A standby letter of credit assures the payment if the buyer does not pay. After fulfilling all the terms under SBLC, if the seller proves that the promised payment was not made.
In this situation, the bank will pay the seller. In a nutshell, it does not facilitate a transaction but guarantees payment.
It is quite similar to a bank guarantee.

Confirmed LC

Although a commercial LC transfers the creditworthiness from the importer to the issuing bank, there is still a chance that even the issuing bank is unable to make the payment.

Unconfirmed LC

A letter of credit that is assured only by the issuing bank and does not need a guarantee from the second bank.
Mostly the letters of credit are the unconfirmed letter of credit.

Revolving LC

When a single LC is issued for covering multiple transactions in place of issuing a separate LC for each transaction is called a revolving LC.

Back to Back LC

Back-to-back LC is an LC that commonly involves an intermediary in a transaction.
There are two letters of credit, the first issued by the bank of the buyer to the intermediary and the second issued by the bank of an intermediary to the seller.

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Sight LC

A sight letter of credit is a type of LC that demands payment on submitting the required documents. The bank reviews the documents and pays the beneficiary if the documents meet the conditions of the letter.

Deferred Payment LC

A normal LC requires the payment to the exporter upon submission of the necessary proofs and documents for complying with the shipment terms and conditions.
On the other hand, a deferred LC gives some time to the importer after the receipt of the goods or commencing the shipment before he is required to pay the amount.

Inland LC

An inland letter of credit is of use in domestic trade transactions, where both the buyer and seller are from the same country. It is used for transactions in the home country. The other term for it is the 'domestic letter of credit.'

Mixed Payments Letter of Credit

Such LCs can have multiple payment terms as well as multiple payment modes. For example, 50% of the payments happen on sight. Another 25% of payments occur after 30 days of shipment. And the remaining 25% of payments will happen on receipt of the shipment.

INDIA'S FOREIGN TRADE AGREEMENT

There are different types of trade agreements that enable preferential market access between India and signatory countries or trade blocs –

- Preferential trade agreements (PTA),
- Free trade agreements (FTA),
- Comprehensive Economic Cooperation Agreements (CECA) and
- Comprehensive Economic Partnership Agreements (CEPA).

TYPES OF FOREIGN TRADE AGREEMENTS :

Comprehensive Economic Cooperation Agreement (CECA)

CECA generally covers negotiation on trade tariff and TQR rates only.
It is not as comprehensive as CEPA.
India has signed CECA with Malaysia.

Global System of Trade Preferences (GSTP)

Under agreement establishing GSTP, tariff concessions are exchanged among developing countries, who have signed agreement.

Comprehensive Economic Partnership Agreement

CECA/CEPA also looks into the regulatory aspect of trade and encompasses and agreement covering the regulatory issues.
India has signed CEPAs with South Korea and Japan.

Asia Pacific Trade Agreement: (APTA)

APTA is a preferential trading arrangement designed to liberalise and expand trade in goods progressively in Economic and Social Commission for Asia and Pacific (ESCAP) region through liberalization of tariff and nontariff barriers.

Preferential trade agreements (PTA),

In this type of agreement, two or more partners give preferential right of entry to certain products.

This is done by reducing duties on an agreed number of tariff lines.

The India Mercosur Preferential Trade Agreement is an example of a PTA.
India signed a PTA with Afghanistan.

Free Trade Agreement :

A free trade agreement is an agreement in which two or more countries agree to provide preferential trade terms, tariff concession etc. to the partner country.

A free trade agreement (FTA) also involves reducing or eliminating tariffs on items traded between the partner countries; however each maintains individual tariff structure for non-members.

So far, India has **signed 13 Free Trade Agreements (FTAs) with its trading partners**, including the 3 agreements, namely

India-Mauritius Comprehensive Economic Cooperation and Partnership Agreement (CECPA),

India-UAE Comprehensive Partnership Agreement (CEPA) and

India-Australia Economic Cooperation and Trade Agreement (IndAus ECTA) signed during the last five years.

The government is working on a revamped strategy for entering into free trade agreements (FTAs) to ensure that FTAs result in providing economic and strategic benefits.

Further, the focus shall be on alliances with “peaceful” countries, especially those with which India does not have a significant trade deficit.

The India-Australia Economic Cooperation and Trade Agreement (ECTA), signed on 2 April 2022, is the first trade agreement of India with a developed country after more than a decade.

The Seventh Trade Policy Review of India by the WTO was undertaken on 6 and 8 January 2021, based on a report by the WTO Secretariat and a report by the Government of India.

The list of FTAs signed by India is as under :

SN	Name of the Agreement
1	India-Sri Lanka Free Trade Agreement (FTA)
2	Agreement on South Asian Free Trade Area (SAFTA) (India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan, the Maldives and Afghanistan)
3	India-Nepal Treaty of Trade
4	India-Bhutan Agreement on Trade, Commerce and Transit
5	India-Thailand FTA - Early Harvest Scheme (EHS)
6	India-Singapore Comprehensive Economic Cooperation Agreement (CECA)
7	India-ASEAN CECA - Trade in Goods, Services and Investment Agreement (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam)
8	India-South Korea Comprehensive Economic Partnership Agreement (CEPA)
9	India-Japan CEPA
10	India-Malaysia CECA
11	India-Mauritius Comprehensive Economic Cooperation and Partnership Agreement (CECPA)
12	India-UAE CEPA (*)
13	India-Australia Economic Cooperation and Trade Agreement (ECTA) (*)

Significance of FTAs

- FTA's or free trade agreement are important to harness the potential resources and to achieve efficiencies by creating competition.
- FTAs encourage businesses in member countries to focus on producing and selling the goods that best use their resources while other businesses import goods that are scarce or unavailable domestically.
- FTAs increase the production and consumption of internationally traded goods as selected goods are produced by every country at lower costs.
- FTAs facilitate the mix of local production and foreign trade which in turn helps economies to boost growth.
- FTAs help diversify supply chains by making it easier and cheaper for more businesses to do business across borders.
- Reducing the trade barriers will help small and medium-sized enterprises in the export of their goods and services.
- Also gives them access to new and emerging technologies.
- From the consumer's point of view, FTAs would help the consumers of both countries see improvements in the variety and affordability of products.

- ✓ FTAs play an important role in strengthening the bond between the countries.
- ✓ FTAs encourage Foreign Direct Investments (FDI) which helps in capital flow and employment creation.
- ✓ FTAs help in eliminating monopolies.

Concerns about FTA

The overall success of trade agreements depends on the extent of new trade created based on comparative advantage, which will boost both trade and economic growth.

However, if the FTA causes large diversions of the trade from more competitive nations to the FTA members, then the overall impact of the FTA will be negative.

Threat to Intellectual property rights, as the products of domestic producers, can be easily replicated by big corporations.
Loss of revenue which was levied in the form of import duties and tariffs.

The exploitation of domestic resources and laborers due to the expansion of foreign corporations.

It increases the dependence of trade in goods and services on other countries.

The free movement of foreign goods affects the domestic goods, leading to losses for the indigenous industries.

South Asia Free Trade Agreement (SAFTA)

South Asian Association for Regional Cooperation or SAARC, as it is known, is a region comprising of all the South-Asian nations or the subcontinent i.e. India, Pakistan, Sri Lanka, Bangladesh, Nepal, Bhutan and the other two countries namely Afghanistan and Maldives.

It was conceived to improve the inter-relationships between the nations and improving people to people contact as all the people are united culturally but divided by the borders.

This was basically done to improve trade and economic relations amongst the member nations of SAARC

With the classification of nations as Least Developing Countries and Non-Least Developing Countries,
there was a creation of an equal platform for all the players in the region so that the Free Trade Agreement would not lead to issues for the domestic markets.

The Indo-Sri Lanka Free Trade Agreement (ISFTA),

which was signed on 28th December 1998 and entered into force with effect from 1st March 2000, provides duty free concessions to a wide range of products traded between the two countries.

Objectives :

Sri Lanka's final tariff liberalization commitment under ISFTA came into effect since November 2008 and with this completion of the commitment, the ISFTA which came into effect from March 2000 has been fully implemented.

However, Sri Lanka has already got a fully duty free access to the vast Indian market under the ISFTA since the end of March 2003.

Thus, the entrepreneurs based in Sri Lanka can now export more than 4000 product lines to the Indian market on duty free basis.

INDIA'S CONCERNS ON TRADE AGREEMENTS

Why has India not been able to evidently gain from the trade agreements vis a vis its trade partners?

Larger tariff reduction by India

Agreements favour partners with excess capacity

Flawed trade rules

Delayed response to measures consistent with the WTO