

Trade & Customs e-Alert

18 JULY 2019

Tariff Classification For Sales Tax

The reintroduction of sales tax highlights the need to be precise in the tariff classification of goods manufactured in or imported into Malaysia. Under the goods and services tax (**GST**) regime, a standard rate of 6% duty was imposed on all taxable goods (except for exempt and zero-rated supplies). However, under the sales tax regime, goods can be either exempted (0%) from sales tax or be subject to sales tax of 5%, 10% or 15%. This sales tax rate differentiation is entirely based on tariff classification. Tariff classification thus becomes a key aspect in determining the sales tax rate payable.

The Australian High Court recently granted special leave to the appeal sought by Comptroller General of Customs (**Australian Customs**) against the Federal Court's decision in *Comptroller-General of Customs v Pharm-A-Care Laboratories* [2018] FCAFC 237. This case concerns the tariff classification of vitamin gummies (**Vitamin Gummies**) and weight loss gummies (**Weight Loss Gummies**) imported by the taxpayer.

Background Facts

The gummies were imported from Germany and were classified by the taxpayer as medicaments under Chapter 30 of the tariff heading. In particular, the taxpayer classified both the Vitamin Gummies as medicaments with prophylactic and therapeutic properties, and the Weight Loss Gummies as garcinia preparations (as the most akin to medicaments) under heading 3004, which are exempted from Customs duties.

However, the Australian Customs rejected the taxpayer's classification of the gummies. The Australian Customs contended that the Vitamin Gummies should be classified under heading 1704 as "sugar confectionery", which attracts 4% duty or, alternatively, under heading 2106 as "food preparations", which attracts 5% duty. Meanwhile, the Weight Loss Gummies should be classified under heading 2106 as "food preparations", which attracts 5% duty.

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The Australian Administrative Appeals Tribunal (**Tribunal**) found in favour of the taxpayer and concluded that the Vitamin Gummies and Weight Loss Gummies are to be classified under heading 3004. Dissatisfied with the Tribunal's decision, the Australian Customs filed an appeal to the Federal Court. The principal contention was whether the gummies should be classified under heading 1704, 2106 or 3004.

Federal Court's Decision

At the outset, the Federal Court affirmed, among other things, the following cardinal principles set out by the Tribunal:

- Tariff classification rules recognise that a particular product may inherently fall under more than one classification. In such circumstances, it may be necessary to ascertain the product's essential character. The essential character of a product is a question of fact to be determined by the Tribunal.
- One must consider a product in the condition in which it is imported. Any labelling which appeared on the product subsequent to its importation would not change its essential character.
- Courts should be cautious in subjecting words in legislation that have an ordinary meaning to intensive analysis. Decision makers should use their local knowledge, experience of the world and common sense to give a sensible interpretation of the words used.

Applying the above principles, the Federal Court upheld the Tribunal's decision to classify the gummies under heading 3004 based on, among other things, the following grounds:

- The essential character of the Vitamin Gummies is to deliver vitamins to the consumer. Although the Vitamin Gummies contain sugar, the presence of sugar was subordinate to the essential character. Thus, the Vitamin Gummies should not be classified as "sugar confectionery" under heading 1704.

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- The Vitamin Gummies should not be classified as “food preparations” under heading 2106 either as they cannot ordinarily be described as “food” due to the vitamins content and the prophylactic and therapeutic properties. The Vitamin Gummies would be more aptly described as “vitamin” or “multi-vitamins”. The fact that the Vitamin Gummies were packaged and sold in retail as dietary supplements did not change the essential character of what had been imported.
- Given the health advantages of weight loss, the essential character of the Weight Loss Gummies appeared to be akin to garcinia preparations under heading 3004. The Australian Customs did not challenge such essential character of the Weight Loss Gummies on appeal. Thus, having so characterised, the Weight Loss Gummies could not also bear the essential characteristics of “food preparation” under heading 2106.

Comments

In Malaysia, the tariff classifications are listed in the Customs Duties Order 2017 (**Customs Order**). Where goods are classifiable under two or more headings, Rule 3 in Paragraph 4 of the Customs Order stipulates that the heading which provides the most specific description shall be preferred to headings providing a more general description. If that is not possible, then, similar to the principle in the *Pharm-A-Care* case, the goods will be classified as if they are consisted of the material or component which gives them their essential character.

The operation of Rule 3 in Paragraph 4 of the Customs Order was demonstrated in *Ketua Pengarah Kastam Diraja Malaysia v Power Root (M) Sdn Bhd & Ors* (Civil Appeal No W-01-295-08/2013). The principal issue in the *Power Root* case was whether the drinks manufactured by the taxpayer were to be classified as “other non-alcoholic beverages” under heading 2202, which attracted 10% sales tax, or as “extracts or concentrates of coffee” under heading 2101, which attracted 5% sales tax.

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Upon considering the ingredient and purpose of the product, the High Court and the Court of Appeal in a concurrent decision found that the essential character of the product was coffee with traditional herbs and thus, it should be rightly classified as “extracts or concentrates of coffee” under heading 2101, regardless whether it was purchased in powder form or in the ready-to-drink liquid form.

Our Tax, SST & Customs senior partner **Datuk D P Naban** and partner **S Saravana Kumar** successfully represented the taxpayer in the *Power Root* case at the Court of Appeal.

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For any questions in relation to tariff classification in respect of sales tax, please contact our Tax, SST & Customs partners at tax@lh-ag.com

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