

# TABLE OF CONTENTS

<b>Overview</b> .....	1
<hr/>	
<b>Recommendations</b> .....	4
<hr/>	
Background .....	4
The Harmonized System Convention .....	4
Executive authority .....	5
Proposed Modifications .....	7
Modifications to bring the HTS into conformity with amendments to the HS Nomenclature .....	9
Multilayer flooring panels .....	9
Hockey pants .....	9
New notes 1(v) and 4 to chapter 95 .....	10
Modifications to bring U.S. Customs practice into conformity with HSC decisions not affecting the international HS Nomenclature .....	13
Drilled or notched lumber .....	13
Safety seats for infants and toddlers .....	13
Certain hygienic articles of plastics .....	14
Multilayer parquet panels .....	14
Photo frame albums .....	15
Probable economic effects of proposed modifications .....	16

## Appendixes

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A.	<i>Federal Register</i> notices concerning this investigation .....	A-1
B.	Proposed modifications to the HTS .....	B-1
C.	Correlation table, sorted by proposed HTS No. ....	C-1
D.	Correlation table, sorted by current HTS No. ....	D-1
E.	Letter from Boen Hardwood Flooring, Inc. ....	E-1
F.	Letter from Bauer Nike Hockey, USA. ....	F-1
G.	Letter from the Foreign Trade Association of Southern California .....	G-1
H.	Letter from the Toy Industry Association .....	H-1
I.	Letters from U.S. Customs and Border Protection .....	I-1
J.	Letter from Baker & McKenzie .....	J-1
K.	Definitions of tariff and trade agreement terms .....	K-1

# OVERVIEW

On September 8, 2004, the U.S. International Trade Commission (the Commission) instituted investigation No. 1205-6, Proposed Modifications to the Harmonized Tariff Schedule of the United States, pursuant to section 1205 of the Omnibus Trade and Competitiveness Act of 1988. The Commission's most recent prior investigation of this issue was Investigation No. 1205-5, Proposed Modifications to the Harmonized Tariff Schedule of the United States (Publication 3430, June 2001). Section 1205 requires the Commission to keep the Harmonized Tariff Schedule of the United States (HTS) under continuous review and to recommend to the President modifications to the HTS in order to reflect amendments to the Harmonized Commodity Description and Coding System (the Harmonized System or HS) that are periodically recommended by the World Customs Organization (WCO), formally named the Customs Cooperation Council (CCC), for adoption, and as other circumstances warrant. In addition to changes in the HS nomenclature, the Commission may take into account decisions issued by the WCO's Harmonized System Committee (HSC) affecting the classification of particular goods, where modifications to the HTS may be required in order to ensure that the subject imported goods continue to receive existing duty treatment. Also, U.S. Customs and Border Protection (Customs) may bring to the Commission's attention those changes in the classification of particular goods that may likewise require the creation of separate tariff categories in order to continue existing duty treatment. The modifications proposed in this report would implement in U.S. law the amendments to the Harmonized System nomenclature that were recommended for adoption by the WCO in June 2004, to become effective as of January 1, 2007, and certain HSC decisions that are necessary and appropriate to ensure uniform application of the nomenclature.

In accordance with section 1205, the Commission solicited, and gave consideration to, the views of interested Federal agencies and the public before proposing recommended modifications to the HTS. The Commission's report to the President presents its recommendations, summarizes the information on which its recommendations are based, presents a concordance of present and proposed

tariff categories, and provides a statement of the probable economic effects of recommended changes on any industry in the United States. Copies of written comments received from Federal agencies and interested parties of the private sector are also included. Issues raised in these comments are summarized in this report.

Notice of this investigation was published in the *Federal Register* on September 14, 2004 (69 FR 55461); the notice made reference to a draft of proposed modifications, which was made available for the purpose of soliciting public comment by placing a copy on the Commission's Internet website. A copy of the *Federal Register* notice is provided in appendix A to this report.

The information contained in this report was obtained from or based upon (a) documents of the WCO, (b) research by the Commission's staff, (c) the Commission's files, (d) consultations with and communications from Government agencies, (e) written submissions from interested parties in the private sector, and (f) other sources. The report includes background information on the international HS and on the procedures involved in its modification, a discussion of proposed modifications requested by Customs, an appendix presenting all of the proposed HTS modifications (appendix B), cross-reference tables (appendixes C and D), and appendixes concerning written submissions (appendixes E through J). A general list of definitions of tariff and trade agreement terms is provided in appendix K.

The Commission's preliminary report was submitted to the Office of the U.S. Trade Representative (USTR) in February 2005, at which time it was also placed on the Commission's Internet website ([www.usitc.gov](http://www.usitc.gov)). It was anticipated that further information may be developed, particularly during the course of discussions at the World Trade Organization (WTO) in connection with the modification of schedules of concessions, in which case it may be necessary to reconsider the derivation of certain tariff rates and possibly to address other issues under negotiation. Accordingly, the Commission's investigation remained open as necessary to address any such matters in order to complete the record. All of the proposed amendments to date are set out in appendix B to this report. Most of the changes between the preliminary report and this final report reflect fine-tuning, editorial and other corrections, primarily those of a technical nature reflecting input from Customs officials. The most

substantial outstanding issue under review since the issuance of the preliminary report was the question of how to reflect new HS note 1(v) to chapter 95, which is discussed in detail below.

# RECOMMENDATIONS

## BACKGROUND

### *The Harmonized System Convention*

Subtitle B of title I of the Omnibus Trade and Competitiveness Act of 1988 (the 1988 Act) approved the United States' accession to the International Convention on the Harmonized Commodity Description and Coding System, which was completed in Brussels on June 14, 1983, under the auspices of the CCC. The Convention establishes a standardized tariff nomenclature,<sup>1</sup> the purpose of which was, and is, to facilitate international trade through the use of a single nomenclature structure for the description, classification, and coding of imports and exports of the contracting parties. This nomenclature, under the requirements of the Convention, assists in the collection, comparison, and analysis of international trade statistics. Article 3 of the HS Convention requires each contracting party to apply the HS nomenclature as the basis of its customs tariff nomenclature and publication of foreign trade statistics.

The HS Convention created the Harmonized System Committee, comprising representatives of all the contracting parties to the Convention. Among the HSC's functions is the preparation of recommendations for achieving uniform interpretation of the HS nomenclature by the members and for keeping the HS product categories current, taking into account technological developments and changing patterns in international trade. These recommendations are issued as amendments to the Convention, especially to the HS annex, and may be reflected in one or more related publications of the WCO, notably the Explanatory Notes to the HS and the Compendium of Classification Opinions, on which the contracting parties rely for guidance in the understanding of the nomenclature. While the Explanatory

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<sup>1</sup> The annex to the HS Convention contains the HS nomenclature and legal rules and notes. The 1988 Act implemented the HTS, which incorporates the structure of the HS nomenclature.

Notes and Compendium are helpful and authoritative sources of such information, they are not legally binding on the contracting parties.

The recommended amendments to the HS generally arise in two contexts: (1) the HSC's actions on classification questions or disputes initiated by members, and (2) the work of a Review Subcommittee (RSC), as its recommendations are subsequently approved by the HSC and ultimately by the WCO. The RSC was established in 1990 by the HSC to review the HS nomenclature on a regular basis and to consider possible changes needed to keep it current with recent changes in technology and trade patterns. Most of the amendments set forth in the WCO's Article 16<sup>2</sup> recommendation and under consideration in this investigation comprise RSC proposals that resulted from its most recent review cycle.

Pursuant to Article 16, amendments to the HS that have been recommended to members by the WCO are deemed to be accepted 6 months after the date of notification of the recommendation, except with respect to contracting parties that notify the WCO of an objection. By agreement of the members, any amendments to the Explanatory Notes or to the Compendium of Classification Opinions are deemed to be accepted when no objection is notified within 3 months of HSC approval.

### ***Executive Authority***

Under sections 1205 and 1206 of the 1988 Act, an administrative mechanism allows the President to proclaim certain types of modifications to the HTS, including changes needed to bring the HTS into conformity with proposed amendments of the HS nomenclature. The Commission is directed by section 1205(a) to keep the HTS under continuous review and to recommend appropriate modifications to the President whenever amendments to the HS nomenclature are adopted by the WCO and as warranted by particular circumstances:

“[The Commission] shall recommend to the President such modifications in the Harmonized Tariff Schedule as [it] considers necessary or appropriate—

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<sup>2</sup> Article 16 of the HS Convention sets out the procedures for amending the Convention and its HS annex, including provisions for contracting parties to notify the WCO Secretary General of objections to any recommended amendment. [See WCO Document 99NL664–Wi/G of July 1, 1999.]

- (1) to conform the [HTS] with amendments made to the Convention;<sup>3</sup>
- (2) to promote the uniform application of the Convention and particularly the Annex thereto;
- (3) to ensure that the HTS is kept up-to-date in light of changes in technology or changes in patterns of international trade;
- (4) to alleviate unnecessary administrative burdens; and
- (5) to make technical rectifications.<sup>4</sup>

Section 1205(d) provides that the Commission cannot recommend a modification to the HTS unless the change (1) is “consistent with the Harmonized System Convention or any amendment thereto recommended for adoption;” (2) is “consistent with sound nomenclature principles;” and (3) “ensures substantial rate neutrality.” Any modification that would change a rate of duty must be consequent to, or necessitated by, recommended nomenclature changes. Finally, the recommended modifications “must not alter existing conditions of competition for the affected U.S. industry, labor, or trade.”

Section 1206 of the 1988 Act authorizes the President to proclaim modifications to the HTS, on the basis of recommendations by the Commission under section 1205, if he determines that the proposed changes are in conformity with U.S. obligations under the HS Convention and do not run counter to the national economic interest of the United States. The modifications can be proclaimed only after the expiration of a 60-day period<sup>5</sup> that begins on the date the President submits a report to the Committee on Ways and Means of the House of Representatives and to the Committee on Finance of the Senate; the report must enumerate the proposed modifications and the reasons for making them. Such proclaimed modifications cannot become effective before the 15th day after the text of the implementing proclamation is published in the *Federal Register*.

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<sup>3</sup> Under the terms of article 2 of the HS Convention, the nomenclature annex is a part of the Convention, and a reference to the Convention is deemed to include a reference to the annex.

<sup>4</sup> Section 1202(6) of the 1988 Act limits the scope of “technical rectifications” to include clerical or typographical errors that do not affect the substance or meaning of the text, such as errors in spelling, numbering, punctuation, or indentation and also to inadvertent errors (including inadvertent omissions) in cross-references between headings, subheadings, or notes, as well as to similar errors.

<sup>5</sup> This period is computed based on “legislative days” and therefore excludes Saturdays and Sundays (unless Congress is in session) and any other day on which either the House or the Senate is not in session.

## **PROPOSED MODIFICATIONS**

A preliminary draft of the Commission's proposed modifications was made available to the public in a document placed on the Commission's Internet site as announced in the notice of institution of the investigation. In addition, various associations and industries were directly contacted to explain the nature of the investigation and to seek input from interested entities. The proposed modifications presented in appendix B to this report and summarized below incorporate revisions made as a result of written comments submitted to the Commission and of any corrections or technical changes deemed necessary (including corrigenda issued by the WCO).

The bulk of the recommendations in appendix B are based upon decisions taken by the HSC during its 24th through 33rd sessions (October 1999 through May 2004), following various actions of the RSC, which submitted its proposals as they were finalized. Though the aim of the RSC in its last review cycle was to concentrate its efforts on high-technology goods of chapters 84, 85 and 90, the WCO's Article 16 recommendation issued on June 26, 2004, contains several hundred amendments affecting 83 chapters and more than 240 headings throughout the nomenclature. These changes are intended to update the nomenclature or clarify the classification of particular goods. For example, printing machinery that formerly was classifiable in various areas of the nomenclature will now be combined into a single heading (8443) ; in another case, a number of changes will be made in the headings covering wood and bamboo products of chapter 44. Certain changes in the Article 16 recommendation require no corresponding changes in the HTS, because the proposals either relate to the French text only or do not require the establishment of additional tariff rate lines to continue existing U.S. duty treatment. In addition, as discussed in the paragraphs set forth below, a few changes contained in appendix B result from requests by Customs.

The duty rates set forth in appendix B are those which are scheduled to be in effect as of January 1, 2007. Any staged duty-rate reductions that have already been established by Presidential Proclamation (e.g., as a result of the various bilateral trade negotiations) will continue to be applied

beyond the January 1, 2007, implementation date, as appropriate. For the purposes of this report, the 2007 staged rates for all such free trade agreements are utilized in the proposed new tariff provisions. The tariff rate lines in appendix B reflect the tariff treatment accorded under chapters 1 through 97 under the Dominican Republic–Central America–United States Free Trade Agreement, which was implemented with respect to El Salvador on March 1, 2006, and was implemented with respect to Honduras and Nicaragua on April 1, 2006; entry into force of the Agreement with respect to the three other contracting parties is not yet scheduled. Nevertheless, all tariff treatment (including that set forth in chapters 98 and 99 of the HTS) accorded under this FTA that may be affected by the appendix B provisions expected to be in effect on January 1, 2007, will be included in the final implementing proclamation to be signed by the President along with future staged duty rates for all previously proclaimed agreements.

In cases where a proposed new HTS subheading represents the combination of two or more present HTS subheadings with differing column 1-general (normal trade relations) duty rates, the proposed general rate is derived from the existing subheading which accounts for a preponderance of the trade in the proposed new subheading. Where combinations at the HS 6-digit subheading level occur, appropriate existing U.S. duty treatment is continued thereunder, and 8-digit tariff lines are created to avoid general duty rate increases or substantive changes in special duty treatment. Further, the proposed duty rates shown may be subject to change as a result of legislation or proclamations that may take effect between the time that the Commission submits its final report to USTR and the projected implementation date of January 1, 2007. Finally, though the USITC report deals only with legal amendments to the HTS, i.e., at the 8-digit level, as will the implementing proclamation, the 2007 version of the HTS will also reflect appropriate statistical subdivisions, textile quota categories, footnotes, etc., which are delineated at the 10-digit level.

## ***Modifications to bring the HTS into conformity with amendments to the HS Nomenclature***

### **Multilayer flooring panels**

In a letter dated November 30, 2004 (appendix E), the law firm of Grunfeld, Desiderio, Lebowitz, Silverman & Klestadt L.L.P. opined that the Commission proposal to provide for multilayer flooring panels in new subheading 4418.72.90 at a column 1-general duty rate of 8 percent ad valorem was not revenue neutral. As indicated above (see section on *Executive authority*), proposals under section 1205 of the 1988 Act are to be “substantially rate neutral.” Grunfeld, et al. argued that the HSC had recently taken a decision to classify such flooring panels in existing subheading 4418.30, which in the HTS is duty free, and that the new subheading 4418.72.90 should therefore also be free of duty. However, the Commission has always interpreted “substantial rate neutrality” to mean that the rate proposed under section 1205 should reflect established U.S. Customs practice. In this case, Customs would normally have classified the subject goods in subheading 4412.22.31 or 4412.29.36. The Commission used the general rate from these subheadings for proposed new subheading 4418.72.90.

### **Hockey pants**

In a late submission dated December 30, 2004 (appendix F), the law firm of Sidley Austin Brown & Wood L.L.P., on behalf of Bauer Nike Hockey, USA, expressed concern that new note 1(v) to chapter 95 might contradict a recent U.S. court case concerning the classification in the HTS of certain imported hockey pants (*Bauer Nike Hockey USA, Inc. v. United States*). In the *Bauer* case, the U.S. Court of Appeals for the Federal Circuit held that the subject hockey pants were classified as sports equipment in subheading 9506.99.25.

New note 1(v), which was adopted by the Harmonized System Committee in different context, specifically excludes from chapter 95 “...apparel...having a utilitarian function...” In its submission, Sidley et al. suggested that the ITC propose modified wording for new note 1(v) to chapter

95 “that more clearly indicates the purpose of this exclusionary note.” However, the text of note 1(v) was approved and adopted at the international level at the WCO and is not open to amendment at the national level. Under the HS Convention, the note cannot now be amended again, even at the international level, without following a long-term procedure in the HSC. That being said, Customs, in its letter of February 25, 2005 (appendix I), indicated that U.S. Customs, in following the *Bauer* decision, will continue to classify the subject hockey pants in chapter 95, regardless of new note 1(v) to chapter 95, because the pants are regarded as “sports equipment” and not as “apparel” for the purposes of that note. Consistent with this reasoning, the Commission has not recommended any new breakouts in HTS section XI to cover hockey pants.

#### **New notes 1(v) and 4 to chapter 95**

The Commission received two late submissions concerning these new notes, which were adopted by the HSC and approved by the WCO Council. One submission (appendix G), dated January 14, 2005, was from the Foreign Trade Association of Southern California (“FTASC”); the other submission (appendix H), dated January 26, 2005, came from the law firm of Sharretts, Paley, Carter & Blauvelt, P.C., on behalf of the Toy Industry Association (TIA).

Both FTASC and TIA expressed concerns about the effect of new note 1(v) to chapter 95 on the classification of imported toys and, in particular, toys put up in sets. Specifically, the concern was that, if a toy set contained a component that was excluded from classification in chapter 95 by virtue of note 1(v), that toy set itself might be ineligible for classification in chapter 95. In its letter of February 25, 2005 Customs noted that the intent of note 1(v) was not to alter the classification of toys, but to reflect the existing scope of chapter 95 and that “articles principally for the amusement of children or adults will continue to be classified as toys in chapter 95.” The Commission notes that new note 4 to chapter 95 is intended to facilitate the classification of toy sets in chapter 95, assuming that such sets retain the essential character of toys, even if they contain one or more components covered by note 1(v).

FTASC also noted that the potential for product shifts arising from new note 1(v) to chapter 95 might be inconsistent with certain existing Customs rulings concerning the classification of certain

products now treated as “festive articles” of heading 9505. The concern was that many products now classifiable in chapter 95 could be transferred to other chapters and classified according to their constituent material.

In its February 25, 2005, letter, Customs acknowledged that certain limited classes of merchandise may be affected by the new note. In the case of *Midwest of Cannon Falls, Inc. v. United States*,<sup>6</sup> certain decorative tableware and kitchenware, having utilitarian function and decorated with three-dimensional representations of an accepted symbol for a recognized holiday, were properly classifiable as festive articles in chapter 95 (heading 9505). Customs suggested that substantial rate neutrality for these articles might be ensured with appropriate breakouts for them in chapters covering tableware and kitchenware. After consideration and consultations, appendix B reflects new subheadings in chapter 98 to provide for duty-free treatment of affected articles, as discussed further below.

Another case noted by FTASC was *Rubie’s Costume Company v. United States*.<sup>7</sup> Customs indicated in its letter that the merchandise at issue in that case was “not affected by new note 1(v) as the court ruled that the merchandise...was not “wearing apparel.” As for the third case noted, *Park B. Smith, Ltd. v. United States*,<sup>8</sup> Customs indicated that it was premature to suggest any changes to the tariff, as the decision was on remand to the Court of International Trade and was not final.

Commission staff met with representatives of both TIA and FTASC on February 10, 2005, to discuss these issues. Both groups agreed to submit further comments outlining specific product groups that might be shifted out of chapter 95 (where they are now free of duty) and into other chapters where they may become dutiable in 2007 as a result of implementing new notes 1(v) and 4 to chapter 95. It was expected that such comments would be submitted directly to the USTR by the end of March 2005; no copies of such comments have been made available to the Commission.

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<sup>6</sup> 122 F.3d 1423 (Fed. Cir. 1997).

<sup>7</sup> 337 F.3d 1350 (Fed. Cir. 2003).

<sup>8</sup> 347 F. 3d 922 (Fed. Cir. 2003). Further information concerning this issue was scheduled to be published in the *Customs Bulletin* of April 5, 2006.

In a letter dated February 10, 2006, the law firm of Baker & McKenzie submitted further comments in this regard, on behalf of its client, Windham Weavers, Inc. (Ridgefield, CT), in connection with *Park B. Smith*. Pursuant to the decision of the Court of International Trade (CIT)<sup>9</sup>, Baker & McKenzie requested that certain new subheadings be inserted in section XI of the HTS to provide duty-free treatment for certain textiles articles that the CIT had determined were properly classified heading 9505 prior to the proposed insertion of new note 1 (v) to chapter 95. This submission, included as appendix J to this report, contained a copy of the Stipulated Judgment from the CIT, which indicated that the textile products in question, previously classified by Customs as textiles articles in section XI of the HTS, were more properly classifiable in heading 9505, as “festive articles.” However, in June 2005, Customs published a notice<sup>10</sup> proposing to limit the application of the CIT decision only to the entries covered by the litigation, without setting precedent for future entries. Customs has indicated that it will issue its final decision in this regard in the *Customs Bulletin and Decisions* on April 5, 2006 (see letter dated March 24, 2006, in appendix I).

After discussions with Customs and USTR, and taking into account the outreach effort to the trading community during this investigation (which did not produce useful input regarding goods which the industry believed might be affected by the new HS note), it was decided that, with respect to goods of heading 9505 that may be affected by note 1(v) to chapter 95, the classification treatment resulting from judicial decisions and also from Customs’ practice over the last 10 years should be reflected in new provisions that would appear in subchapter XVII of chapter 98 of the HTS, a subchapter that contains various tariff provisions to ensure that appropriate treatment under trade agreements is continued. Chapter 98 is a national-level chapter that is not part of the international nomenclature structure, and thus certain duty treatment that cuts across tariff chapters can most easily be reflected therein. Any additional

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<sup>9</sup> Court No. 96-00344, dated April 6, 2005, and signed by the Honorable Richard W. Goldberg, Senior Judge.

<sup>10</sup> “Proposal to Limit the Decisions of the Court of International Trade and the Court of Appeals for the Federal Circuit in *Park B. Smith v. United States*” (*Customs Bulletin and Decisions*, Vol. 39, No. 27, June 29, 2005). Customs cited 19 U.S.C. 1625(d) as the authority for this action.

information received by the Commission after issuance of this report could be considered during the preparation of the HS 2007 implementing proclamation in consultation with Customs and USTR.

***Modifications to bring U.S. Customs practice into conformity with HSC decisions not affecting the international HS Nomenclature***

In a letter dated February 22, 2005, Customs indicated that the Harmonized System Committee had taken several classification decisions since May 1999 that did not result in changes to the international HS, but which were counter to established U.S. Customs practices and court rulings. In order to bring the HTS into conformity with the HSC decisions, Customs requested that certain additional proposed legal amendments be included in this investigation, along with the other amendments arising from the WCO's recommendation of June 26, 2004. The main areas of concern are briefly summarized below. All of the amendments discussed below are incorporated in appendixes B, C, and D.

**Drilled or notched lumber**

Customs indicated that drilled or notched lumber studs had been classified by the HSC as builders' joinery in heading 4418, whereas Customs practice was to classify such products in heading 4407. In order to conform to the decision, Customs asked that an additional U.S. note be inserted in the HTS to provide a legal basis for the classification in heading 4418, and that a separate rate line for drilled or notched lumber studs be inserted in heading 4418 to carry over the established duty treatment from heading 4407. These amendments are reflected in appendix B.

**Safety seats for infants and toddlers**

As indicated by Customs, the HSC had classified certain child safety seats, not as "seats of a kind used for motor vehicles" (subheading 9401.20.00), but rather as "other seats" of subheading 9401.80. Customs requested an additional U.S. note to provide legal clarification of

this classification in the HTS. Given that the duty rate involved is “free” in either case, Customs did not ask for a separate rate line for child safety seats under HS subheading 9401.80, but did ask that the statistical annotation for such seats under present subheading 9401.20 be maintained in the 2007 HTS under subheading 9401.80.

### **Certain hygienic articles of plastics**

Given that the HSC had agreed that hygienic articles of plastics should be classified together in heading 3924, certain hygienic articles traditionally classified by Customs in heading 3926 would be transferred after January 1, 2007. To reflect these transfers, Customs requested a new subheading for “nursing nipples and finger cots” under heading 3924, as well as amendments to the article descriptions for existing subheadings 3926.90.15 and 3926.90.20. These two subheadings will be renumbered in 2007 to indicate a change in their scope. Customs also noted that “crutch tips and grips” (in existing subheading 3926.90.20) were more properly classifiable in heading 9021. The Commission has not proposed a separate subheading for these products in heading 9021, but merely indicated the transfer by renumbering the residual or “basket” subheading 9021.90.80 as 9021.90.81 to reflect a change in scope of that subheading.

### **Multilayer parquet panels**

The HSC considered the classification of certain multilayer flooring panels, consisting of 2 or 3 layers, the face layer being finished wood measuring 4 mm in thickness. The Committee classified the products as builders’ joinery in heading 4418, despite the U.S. argument that they met the criteria for veneered or laminated wood panels of heading 4412. The established Customs practice of classifying these products in heading 4412 was consistent with a court decision, *Boen Hardwood Flooring Inc. v. United States* (357 F.3d 1262 (Fed. Cir. 2004)). Therefore, in order to have a legal basis for following the HSC decision in this regard, Customs

asked for a new additional U.S. note 4 to chapter 44 (see app. B), as well as new rate lines in heading 4418 to cover the products in question.

### **Photo frame albums**

Though Customs had a long history of classifying photo albums of plastics as household articles of heading 3924 , the HSC recently classified two different samples of such albums in heading 3926 (other articles of plastics). Here again, Customs requested an additional U.S. note to chapter 39 and a new rate line for photo albums in heading 3926, in order to provide a sufficient legal basis for classifying these goods in that heading.

## **PROBABLE ECONOMIC EFFECTS OF PROPOSED MODIFICATIONS**

The Commission considers the proposed modifications to be appropriate to provide for the goods concerned under the proper HS headings or subheadings without altering existing Customs tariff treatment. Furthermore, the modifications would not significantly alter existing conditions of competition for the affected U.S. industries, labor or trade. Consequently, the information collected by the Commission indicates that these modifications, if proclaimed, would ensure substantial rate neutrality and would have little or no economic effect on U.S. industry or labor.