WHEN IS A DRINK NOT A BEVERAGE? HIGH COURT RULES ON YAKULT'S TARIFF CLASSIFICATION

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In a recent decision, the High Court allowed the judicial review application filed by Yakult (Malaysia) Sdn Bhd (the Company) and set aside the Royal Malaysian Customs Department's (Customs) decision to reclassify the Company's manufactured products, namely "Yakult Ace" and "Yakult Ace Light" (the Products), from fermented milk to beverages.

The reclassification carried potentially significant fiscal consequences. Based on the applicable rates, classification as beverages would have increased the sales tax rate from 5% to 10% and the import duty rate from 0% to 20%. The High Court held that the addition of water and the Products' ready-to-drink form did not alter their essential character as fermented milk products

The decision is significant for manufacturers of functional foods, dairy products and other goods whose physical form or composition changes during production. It demonstrates that water content and presentation should not be considered in isolation. Tariff classification must be undertaken in accordance with the General Rules for the Interpretation of the Harmonised System (General Rules), having regard to the terms of the relevant headings and the product's objective characteristics.

Background

The Company is a wholly-owned subsidiary of Yakult Honsha Co Ltd, a Japanese multinational corporation. It manufactures probiotic fermented milk products containing over 30 billion live Shirota strain bacteria per 80ml bottle, together with skimmed milk powder, sugar, glucose, and permitted flavouring. The Products are marketed and consumed as probiotic fermented milk products intended to support gut health.

Under the manufacturing licence issued by the Customs on 4 November 2003, the Products were initially classified as "other fermented or acidified milk" under the Customs Duties Order 2002. Following the repeal of that Order, the Products continued to be classified under tariff code 0403.90.9000 also as "other fermented or acidified milk", under the Customs Duties Order 2022. This treatment remained undisturbed for approximately 20 years before Customs decided that the Products should instead be classified under tariff code 2202.99.5000 as "other non-aerated beverages ready for immediate consumption without dilution". The Company challenged that decision by way of judicial review.

The two competing tariff classifications were as follows:

Heading / Tariff Code	Description	Sales Tax	Import Duty
04.03	Yogurt; buttermilk, curdled milk and cream, kephir and other fermented or acidified milk and cream, whether or not concentrated or containing added sugar or other sweetening matter or flavoured or containing added fruit, nuts or cocoa.		
0403.90.9000	Other	5%	0%
22.02	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavoured, and other non-alcoholic beverages, not i ncluding fruit, nut or vegetable juices of heading 20.09.		
2202.99.5000	Other non-aerated beverages ready for immediate consumption without dilution	10%	20%

The Dispute

The central issue before the High Court was whether the Products were properly classified as fermented milk products under tariff code 0403.90.9000 or as beverages under tariff code 2202.99.5000. The dispute centred on whether the addition of water and the Products' ready-to-drink form changed their character for tariff classification purposes.

Under paragraph 4(1) of the Customs Duties Order 2022, tariff classification is governed by the General Rules for the Interpretation of the Harmonised System (General Rules). The General Rules therefore provided the legal framework for determining which of the two competing tariff classifications applied to the Products.

Against this framework, Customs submitted that the Products were properly classified under heading 22.02 because their manufacturing process, composition and finished form showed that they were ready-to-drink beverages rather than fermented milk products falling under heading 04.03. In particular, Customs relied on the addition of more than 56% sterile water after fermentation, which it argued had altered the Products' essential character from fermented milk to a "drink based on fermented milk". Customs also relied on the Products being labelled and marketed as "cultured milk drinks" and being ready for immediate consumption without further dilution.

Customs further submitted that the classification could be determined under Rule 1 by reference to the wording of headings 04.03 and 22.02. Alternatively, Customs contended that heading 22.02 provided the more specific description under Rule 3(a), while Rule 6 supported classification under tariff code 2202.99.5000. Customs also relied on the Codex Alimentarius standard for fermented milk and the Ministry of Health's view that the Products were cultured milk drinks rather than yoghurt.

The Company's Case

The Company's position was anchored principally on Rule 3(a). It submitted that heading 04.03 provided the more specific description because it expressly covered "other fermented or acidified milk", whereas heading 22.02 covered the broader category of non-alcoholic beverages.

In *Ketua Pengarah Kastam v Amaire Auto Sdn Bhd & Anor* [2025] CLJU 2018, the High Court held that classification under Rule 3(a) requires the heading providing the most specific description to be preferred to a heading providing a more general description.

If classification could not be determined under Rule 3(a), the Company relied alternatively on Rule 3(b). It contended that the Products retained the essential character of fermented milk when assessed by reference to their composition, primary function and intended use.

In *Jindar Sdn Bhd v Director General of Customs, Royal Malaysian Customs Department & Anor* [2025] MLJU 2879 the High Court explained that, where classification turns on essential character, the inquiry may focus on the function and intended use of the goods rather than physical form alone.

The Company also relied on *Ketua Pengarah Kastam v Power Root (M) Sdn Bhd & Ors* (Rayuan Sivil No.: W-01(1M)-441-10) in which the Court of Appeal upheld the High Court's decision. The Court observed the absurdity of equating water content with beverage classification, noting that products containing substantially higher water content cannot be classified as beverages where their intended use and consumers' expectations are not for thirst-quenching or refreshment, but for health and nutritional purposes. Their essential character remains unchanged, whether presented in powdered form or as a ready-to-drink liquid form.

In the present matter, each 80ml bottle contained more than 30 billion live Shirota strain bacteria. The small serving size, composition, marketing and intended purpose were relied upon as evidence that they are consumed principally as a functional fermented milk product for gut health, rather than as a conventional beverage to quench thirst. The Company further emphasised that consumption of the Products in liquid form does not transform the Products into beverages for tariff classification purposes.

Moreover, the World Customs Organisation's (WCO) Explanatory Notes to heading 04.03 also state that products under this heading may be in liquid, paste or solid form and may be concentrated or preserved. The Explanatory Notes therefore recognise that the physical form of fermented milk products may vary and the addition of water would not automatically render the Products as a beverage.

Consistency And Uniformity In Tariff Classification Treatment

The Company also highlighted the Customs' inconsistent classification practice including the fact that a similar probiotic dairy drink manufactured by a competitor continued to be classified under heading 04.03, rather than as a mere beverage, notwithstanding that both products contained comparable water content.

The Company further submitted that its proposed classification was consistent with the treatment of the Products in other WCO member states, including Singapore and United Arab Emirates. The Harmonised System exists to promote uniformity and consistency in classification of goods across member states so as to facilitate international trade.

This approach has been endorsed by the High Court in *Howe Keat Sdn Bhd v Ketua Pengarah Kastam, Jabatan Kastam Diraja Malaysia* [2024] MLJU 1537 and by the Federal Court in *Nike Sales (M) Sdn Bhd v Jabatan Kastam Diraja Malaysia & Ors* [2013] 5 MLJ 21. Those decisions recognised that customs classification should not be approached as an entirely isolated domestic exercise and that due regard may be given to international and comparative practice.

Moreover, the long-standing classification of the Products under heading 04.03 over 23 years, supported by the manufacturing licence issued by the Customs, gave rise to the Company's legitimate expectation that the Customs could not depart from its established position without proper justification.

The High Court's Ruling

The High Court allowed the Company's judicial review application and set aside Customs' reclassification decision. The Court held that the Products had a strong basis to be characterised as fermented milk and should properly fall under tariff code 0403.90.9000, noting that the heading 04.03 expressly includes *"yoghurt... and other fermented or acidified milk and cream."*

The Court recognised that the core composition of the Products remains that of fermented milk containing live bacteria cultures, skimmed milk powder, sugar and flavouring, notwithstanding the addition of water.

Crucially, the Products retained the essential character of fermented milk associated with gut health benefits rather than that of a conventional thirst-quenching beverage. The Court further observed that, from the perspective of the ordinary consumer, the name "Yakult" is associated with a fermented milk product for gut health rather than an ordinary beverage consumed casually.

Accordingly, the High Court concluded that the addition of water during the manufacturing process did not displace the essential character of the Products as fermented milk. The Products should therefore remain properly classified under tariff code 0403.90.9000.

Why This Decision Matters

First, the decision confirms that tariff classification is not determined merely by a product's physical form or presentation. The classification exercise must follow the General Rules and consider the terms of the competing headings. Where Essential character becomes relevant, the product should be assessed holistically, by reference to its composition, function, intended use and consumer perception.

Secondly, the addition of water or presentation in ready-to-consume form does not necessarily alter a product's tariff identity. This is particularly relevant to manufacturers of functional foods and dairy products, which may be diluted or sold in liquid form to facilitate consumption without losing their underlying character.

Thirdly, the decision illustrates the practical importance of consistency and proper justification in tariff administration. Although Customs may reconsider an earlier classification in the exercise of its statutory functions, a departure from treatment maintained over many years should be supported by a careful application of the General Rules and the relevant technical material.

The decision also has implications beyond the dairy industry. Many manufactured products undergo dilution, blending, concentration or other changes before reaching their final form. Businesses should therefore retain technical documents explaining a product's composition, manufacturing process, function and intended use, together with relevant overseas rulings and historical correspondence with Customs. These materials may become important if an established tariff classification is subsequently reviewed.

From a compliance perspective, businesses should also avoid relying solely on product labels or marketing descriptions. A label may be relevant evidence, but it does not replace the legal classification exercise. Product specifications, laboratory reports, ingredient ratios, manufacturing flow charts, relevant Section and Chapter Notes, and the World Customs Organization's Explanatory Notes should be considered together before a tariff position is adopted or revised.

Where Customs proposes to depart from a long-standing classification, taxpayers should identify the precise change said to justify the new treatment. This may include a change in the product's formulation, the applicable tariff legislation, the relevant Explanatory Notes or the technical evidence available to the decision-maker. If none of those matters has materially changed, the basis for treating the same product differently should be clearly explained.

Ultimately, the decision provides a useful reminder that tariff classification must reflect what a product objectively is, rather than simply how it is presented or consumed. A change in physical form, the presence of water or the ability to consume the product immediately should not, without more, displace its substantive identity.

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