

# Classification and Its Relevance in GST Regime

*Classification means arranging in classes or categorising things according to shared qualities or characteristics. Under the Goods and Services Tax (GST) laws, classification of goods and services help in determining its taxability, i.e., the applicable rate of tax or exemption from payment of tax, as the case may be. The scheme of classification of goods is framed in accordance with the Customs Tariff Act, 1975 (hereinafter referred to as 'CTA') which is in-turn based upon the Harmonised Coding System, while classification of services is a modified version of the United Nations Central Product Classification. In this article, we intend to limit our discussions on classification of goods. Read more...*



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India being a signatory to the International Convention on the Harmonized Commodity Description and Coding System, 1983, has adopted the classification codes and the General Rules of Interpretation (*GI Rules*) as prescribed under the Convention. The classification of goods is governed by the provisions under the CTA. The First Schedule to the CTA specifies the nomenclature that is based on the Harmonised Commodity Description and Coding System generally referred to as "Harmonized System" or simply "HS", developed by the World Customs Organization (WCO).

## Methodology of Classification

The Harmonised System (*HS*) provides commodity/product codes and description up to 4-digit (Heading) and 6-digit (Sub-heading) levels only and member countries of WCO are allowed to extend the codes up to any level subject to the condition that nothing changes at the 4-digit or 6-digit levels. India has developed 8-digit level classifications to indicate specific statistical codes for indigenous products and also to monitor the trade volumes. For legal purposes the texts of the section notes, chapter Notes, subheading



notes, supplementary notes, headings, subheadings, and the GI rules should be relied upon to determine the classification of an item.

### General Rules for Interpretation

Classification of goods covered under the First Schedule to the CTA, is done as per the GI Rules. The GI Rules is a set of six rules for classification of goods in the Tariff Schedule. These rules have to be applied sequentially.

- Rule 1 gives precedence to the section or chapter notes while classifying a product.
- Rule 2(a) applies to goods in incomplete or unfinished condition having essential character of complete or finished goods, presented in unassembled or disassembled form. Rule 2(b) is applicable to 'mixtures' and 'composite goods'.
- Goods which cannot be classified by application of Rule 2(b), shall be classified by application of Rule 3, i.e., by application of 'most specific description' as per Rule 3(a) or by ascertaining the 'essential character' of the articles per Rule 3(b) or by taking into consideration the heading that occurs last in the numerical order as per Rule 3(c).
- Goods which cannot be classified in accordance with the above rules will

be classified under the heading appropriate to the goods to which they are most akin, by application of Rule 4.

- Rule 5(a) and (b) relate to classification of packing materials and packing containers.
- Rule 6 lays down that for legal purposes, the classification of goods in the sub-headings of a heading shall be determined according to the terms of those sub-headings and any related sub-heading notes and, mutatis mutandis, to the above rules, on the understanding that only sub-headings at the same level are comparable. For the purposes of this rule the relative section and chapter notes also apply, unless the context otherwise requires.

### HSN and Classification

The CTA is based on harmonised system of nomenclature; but Tariff nowhere states that notes in HSN will be applicable for its interpretation. For the purpose of uniform interpretation of HSN, the WCO has published detailed explanatory notes to various heading and sub-headings. WCO in its various committees discusses classification of individual products and gives classification opinion of the same. Such information, though not binding in nature, provides a useful guideline for classifying goods.

In the case of **O.K Play (India) Limited v. CCE [2005 (180) ELT 300 (S.C)]** the Hon'ble Supreme Court of India made the following observations:

- (a) There cannot be a static parameter for correct classification.
- (b) HSN along with the explanatory notes provide a safe guide for interpretation of an entry.
- (c) Functional utility, design, shape and predominant usage have also got to be taken into account while determining the classification of an item.
- (d) Aforestated aids and assistance are more important than the names used in the trade or common parlance in the matter of correct classification.

It was held by the Hon'ble Apex Court in **L.M.L Limited v. CC [2010 (258) ELT 321 (S.C)]** that in order to resolve a dispute on tariff classification, internationally accepted nomenclature emerging from HSN explanatory notes is a safe guide for classification. It was also held that the HSN explanatory notes are also dependable guide for interpretation of Customs Tariff apart from interpreting Central Excise Tariff.

As discussed supra, the Customs Tariff generally is

based on the tariff classification adopted by WCO in its harmonised commodity description of coding system. Hence, wherever a chapter of Customs Tariff is fully aligned with the corresponding chapter of HSN, the HSN explanatory note explaining the scope of headings of that chapter would have persuasive value in the determination of scope of headings of correspondence chapter of customs Tariff. It is therefore fairly settled that the explanatory notes provided in HSN is an important aid for ascertaining the classification of a product.

### Principles of Classification

In addition to the aforesaid rules and principles of classification, certain principles for classification have been evolved over time by the Courts and Tribunals. Few of such significant principles are:

- (a) **Trade Parlance:** As per this principle, the popular meaning attached to that by those using the product is to be considered and not the scientific and technical meaning of the product for the purpose of classification.
- (b) **Relevance of end use:** This principle states that the end use to which a product is put cannot be the basis for determination of its classification. Further, the product should be classified based on its statutory fiscal

entry, basic character, function and use of the product.

#### (c) Other principles of classification

- Condition of material at the time of import or clearance;
- Mere separate price in invoice does not mean goods are to be classified separately;
- Exemption notification cannot determine classification;
- Method of showing separate prices in invoice does not mean goods are to be classified separately;
- Classification cannot be decided on basis of advertisement or product literature of the product;
- Product literature cannot be sole basis for classification.

### Classification Disputes under GST

The Central Board of Indirect Taxes and Customs (CBIC) has issued notifications prescribing rate of applicable on supply of goods falling under different chapters, chapter headings or tariff Items. The tax rates are revised from time to time as per the recommendations of the GST Council. These rates are



It is also pertinent to note that taxpayers are mandatorily required to mention 8 digits Tariff Entry for certain category of goods falling under Chapter 28 (organic chemicals), Chapter 29 (pharmaceutical products), Chapter 38 (miscellaneous chemical product) and Chapter 39 (plastics and articles thereof) with effect from 01.12.2020.

divided among multiple slabs (Nil, 0.25%, 3%, 5%, 12%, 18% and 28%) and taxability of each of the products is dependent on its classification. It is therefore natural to expect disputes in determining classification of goods on account of the difference in interpretation of entries in the rate notification between taxpayers and authorities. The CBIC has issued Circulars providing clarification on classification of goods and services from time to time; however, some of these clarifications have led to unsettling the issue.

### Recent Amendments

The CBIC has notified<sup>1</sup> that taxpayers with turnover upto ₹ 5 crores and beyond are

<sup>1</sup> Notification No. 78/2020-C.T., dt. 15.10.2020



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required to mention HSN at 4 digit and 6 digit, respectively, on their tax invoices with effect from 01.04.2021. It is also pertinent to note that taxpayers are mandatorily required to mention 8 digits Tariff Entry for certain category of goods<sup>2</sup> falling under Chapter 28

(organic chemicals), Chapter 29 (pharmaceutical products), Chapter 38 (miscellaneous chemical product) and Chapter 39 (plastics and articles thereof) with effect from 01.12.2020. The taxpayers claiming refund of ITC are also required to provide category of input supply along with HSN wise details<sup>3</sup> of goods and services in their refund application (in Annexure 'B'), so as to enable the authorities to easily identify the goods and services.

#### Endnote

Determination of classification of goods is not a new phenomenon for importers and

manufacturers. It has, however, gained more prominence now since it is one of the mandatory requirements for almost all the taxpayers (including service providers) under GST regime. It is therefore imperative for taxpayers to take due care in identifying accurate classification of goods and services supplied by them. Supplying goods or services under incorrect classification may not only result in tax disputes but also attract penal provisions. It is therefore advisable for all taxpayers to regularly review the correctness of classification adopted with respect to goods or services supplied by them. ■■■

<sup>2</sup> Notification No. 90/2020-C.T., dt. 01.12.2020

<sup>3</sup> Circular No. 135/05/2020-GST, dt. 31.03.2020

## ICAI News

### Survey For Seeking Preference For Learning Foreign Language Through Virtual Mode From Icai Members And Students

**Last Date: 15<sup>th</sup> April, 2021**

Committee for Development of International Trade, Services & WTO (CDITSWTO) of ICAI is taking forward the Action Plan for Champion Sector in which promoting foreign language amongst members and students is one of the mandates by Government of India.

With an aim to overcome language barrier and thereby to have enhanced professional opportunities overseas, ICAI, under the aegis of the Committee had initiated online batches of German, French, Spanish, Japanese and Business English Languages for its members and students through German, French, Spanish, Japanese and British Embassy and is working to initiate batches for Chinese, Arabic and Dutch languages in next few months based on the demand for said foreign languages.

Interested members/students are requested to kindly express their interest for the preferred foreign language which would facilitate ICAI to open up future batches of foreign languages. The expression of interest can be provided at <https://www.icai.org/post/survey-seeking-preference-for-learning-foreign-language> latest by 15<sup>th</sup> April 2021.

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