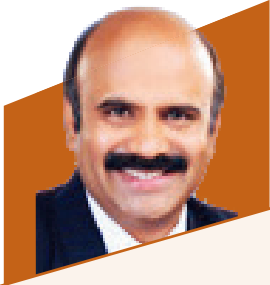


## Classification under GST: Role of HSN



Since the introduction of GST many WhatsApp groups have been created by all and sundry and the most common query that one would find in such groups is “what is the rate of GST for such and such product” and you find as many answers as are the rates in the law. Little does the querist know about the huge risk involved in converting a classification question into a mere question of rate of tax.

### What is classification?

There are thousands of tradable commodities chargeable to different rates of tax. Then how does one ascertain the applicable rate of tax on a particular product. The answer to this question is by classifying goods in different groups sub-groups according to their nature, composition etc. and then specifying rate for each such group of commodities. One may think that it would take some logical understanding and trade knowledge to classify goods, but this is easier said than done. For example, how would a gold pen be classified – as an item of gold or as a pen? The HS comes to rescue here by providing

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a uniform and standardized system of classification. The HS Code and the description of the commodity may not always be in tandem with the general commercial parlance and may throw surprises e.g., a commodity which should be charged at 5% as per general understanding, may either be exempted or charged at a higher rate given the HS code and the Chapter under which the same is found.

### What is HS?

The Harmonized Commodity Description and Coding System generally referred to as “Harmonised System” or “HS” is an international product nomenclature developed by World Customs Organization (WCO) to ensure uniform classification of goods in international trade. In addition to its use in customs, HS is also used by the Governments across the globe as a statistical tool in economic research and devising trade policies. HS comprises of more than 5,000 commodities grouped under Sections and then Chapters, which are arranged in a logical structure. Under a chapter, each commodity is identified by a 6 digit code and a uniform classification is ensured by way of well-defined rules to read and interpret the HS.

The Harmonized System Convention entered into force on January 1, 1988. India too adopted the Convention as one of the founder-Contracting Party. With 13 countries on Board, 4 more countries were required by September 30, 1987, so that the HS could be rolled out on January 1, 1988. On September 22, 1987, 15 new countries joined, thus enabling the roll out on the determined date. Today more than 200 countries have adopted HS in formulating their customs tariff.

“The International Convention on the Harmonized Commodity Description and Coding System” governs the HS. The Explanatory Notes published by WCO provide the official interpretation of the HS. The Harmonized System Committee (representing the Contracting Parties to the HS Convention) of WCO is entrusted with the task of providing uniform interpretation of the HS and updating the same every 5-6 years to keep pace with the technological developments and evolving trade patterns. The other functions of the Harmonized System Committee include examining policy matters, deciding classification questions, settling disputes, preparing amendments to Explanatory Notes and the like.

In May 2019, the World Customs Organisation (WCO) held the 1<sup>st</sup> ever public consultation on the revision of HS. Since 1996, HS has been amended 7 times, the 7<sup>th</sup> such amended version became applicable from January 1, 2022. International Convention on

Harmonized System requires the contracting parties to amend their Tariff Schedules in alignment with HS. Therefore, the classification of products may not be static; it may change over a period of time and thus, correlation tables showing the corresponding new classification for an old classification under HS and *vice versa* may be referred to for knowing the changes, if any.

“HS” is an international product nomenclature developed by World Customs Organization (WCO) to ensure uniform classification of goods in international trade.

The HS aims to establish taxonomy system for goods. A hierarchy is provided under which goods can be classified to ensure standardization across the member countries. For example, a balloon, being a toy, is understood to be classifiable under HSN

9503 uniformly across all the member countries.

### How is HS adopted in India?

In India, the classification of imported and export goods is governed by Customs Tariff forming part of Customs Tariff Act, 1975. By classification, it is meant the specific heading/tariff entry of the Schedules of the Customs Tariff under which a particular product/commodity falls. The Customs Tariff is divided into two Schedules - First Schedule is Import Tariff (specifying goods liable to import duty) and Second Schedule is Export Tariff (specifying goods liable to export duty). As customs duty rates (Tariff) are also specified against the classification (heading/entry) of a commodity in a Schedule, it is called the “Indian Customs Tariff” or “Tariff Schedule”.

Initially, the Import Tariff was based on the Customs Co-operation Council Nomenclature, also known as “Brussels Tariff Nomenclature”. However, with effect from

28.2.1986, the said Tariff was revised basis the HS adopted by WCO. The “Harmonised Commodity Description and Coding System” developed by WCO came into effect in the Harmonised System Convention from 01.01.1988.

As mentioned above, commodities are coded up to 4 (Heading) and 6 (Sub-heading) digits in HS. However, the WCO member countries have been provided the flexibility to extend the codes up to any level as per their requirement provided that they do not change the codes at the 4-digit or 6-digit levels. Until 31<sup>st</sup> January, 2003, the Customs Tariff consisted of 6 digit code. However, with effect from 1.2.2003, India adopted 8-digit level classification to monitor trade data and provide specific statistical codes for domestic products.

The Customs Tariff has 21 Sections and 98 Chapters. Chapters covering a class of goods are grouped under one Section. Every Section and Chapter has Section Notes and Chapter Notes respectively which explain the scope of Chapters/headings etc. In each Chapter, brief description of commodities is given at 4, 6 and 8 digits where 4 digits denote a heading, 6 digits denote a sub-heading and 8 digits denotes a tariff item. Rate of duty is specified against each tariff item. All the commodities/products are arranged in a definitive pattern in the Tariff which is increasing order of their manufacture - first natural products,

“In India, the classification of imported and export goods is governed by Customs Tariff forming part of Customs Tariff Act, 1975.”

### How has the HS kept the World Nations bound by its terminology? How the trade has been facilitated through codes?

The WCO Preamble to HS is reproduced hereunder:

*“Desiring to facilitate International Trade*

*Desiring to facilitate the collection, comparison and analysis of statistics, in particular those on international trade*

*Desiring to reduce the expense by re-describing, reclassifying and recoding of goods as they move from one classification system to another in the course of international trade and to facilitate the standardization of trade documentation and the transmission of data”*

As seen from the Preamble to the HS, the aim is to assist member countries of the WCO in facilitating international trade, collecting data and ensuring uniform codes so as to reduce the expenditure involved in recoding of internationally traded goods.

then raw materials; then semi-finished goods, and in the last fully finished goods/article / machinery, etc.

Therefore, now it can be inferred that classification is a process of determining the specific heading (4 digit) or a sub-heading (6 digit) or the tariff entry (8 digit) for a given product/commodity so as to know the applicable rate of duty chargeable on it. The titles of Sections, Chapters etc. provided in the Tariff are solely for the ease of reference and do not have any legal authority. A legally correct classification can be determined by using texts of Section Notes, Chapter Notes, Headings, Subheadings, and the General Rules for Interpretation of Import Tariff (GIR). There are 6 rules in the GIR which provide guidance for determining classification of goods in different scenarios. These rules are to be applied sequentially.

### Why is HS applicable to GST in India?

Notification No. 1/2017 - CT (Rate) dated 28.6.2017, popularly called as GST Rate Notification, contains the schedules of rate of tax to be levied on goods supplied under the GST law. Originally there were 6 schedules; the 7<sup>th</sup> was added with effect from July 18, 2022. Notification No. 2/2017 - CT (Rate) dated 28.6.2017 enlists the goods which are exempt from GST. In both the above notifications goods are classified basis Chapter/Heading/Sub-heading/Tariff Item and then applicable rate of tax/exemption is provided against each goods.

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**The 8-digit HS code is the basis of the code that is contained in the GST Rate Notification.**

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*“Chapter” shall mean respectively a tariff item, sub-heading, heading and chapter as specified in the First Schedule to the Customs Tariff Act, 1975 (51 of 1975)*

*(iv) The rules for the interpretation of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975), including the Section and Chapter Notes and the General Explanatory Notes of the First Schedule shall, so far as may be, apply to the interpretation of this notification.*

The above explanation clearly lays down the importance of Customs Tariff Act in classifying a commodity under GST and consequently determining the rate at the which the same is taxed.

As already premised above, India has adopted the HS and consequently the Customs Tariff Act contains the HS and the commodity descriptions released by the World Customs Organisation. The 8-digit HS code is the basis of the code that is contained in the GST Rate Notification. Hence, whenever there arises a need to find the rate of GST, it is the Customs Tariff Act which should first be referred to instead of the GST rate Notification. Having done the same, the result should be

Clauses(iii) and (iv) of the explanations to both the above Notification are reproduced hereunder:

*(iii) “Tariff item”, “sub-heading”, “heading” and*

compared with the GST rate Notification and if there is a difference between them, then the GST Rate notification shall prevail. However, such difference should be brought to the notice of the Fitment Committee, so that the anomaly can be addressed suitably. If the same is not addressed, commodity imported would fall under the respective HSN as per Customs Tariff Act and if the same is supplied domestically, it would merit classification as per the relevant entry in the GST rate notification. Thus, it is quite possible that there will be a difference between the rate of tax under IGST and the rate when charged for domestic supplies.

In matters relating to classification, the process that goods pass through may also have a bearing and in thus, the concept of manufacture as prevalent during the excise times may be referred to. The decisions of the Supreme Court can act as guidance while deciding whether a commodity is X or whether it is Y and under which HSN the same would fall. The product under question may be the same but the ingredients added to it may give rise to differential rates. For example, flavoured milk in plain form is different

from the flavoured milk added with nuts. Similarly, commodities can be differentiated when the same are ‘ready-to-cook’ or ‘ready-to-eat’. The GST Rate Notification is brought in to facilitate the trade that entered the HS domain for the

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**The Scheme of Classification of Services under GST along with the Explanatory Notes are based on United Nations Central Product Classification.**

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first time. Hence, there is bound to be a mismatch with Customs HS. One may find mention of products in Customs HS but the same may be missing in GST rate notification

e.g., mango Pulp finds a specific mention in Customs HS whereas the same is missing in GST rate notification which gave rise to issues relating to its taxability.

With revenue considerations, Department is duty bound to look into the rate issues and the differences between GST and Customs HS will throw up interesting and probably avoidable legal tussles. Professionals should visit the place of production, read literature related to the product, relevant details on the packaging, marketing strategies etc. which emanate a lot of information on the nature of the product. This will help the professionals to strike a balance between both the laws, and instead of getting into protracted litigation, reach a conclusion. They should also look into decisions of the Courts in the past as the same may throw light on the exact nature of the product and its entry under the relevant Heading.



**Accurate classification of goods and services is vital for determining the correct GST liability.**



### How are services classified in GST?

GST is levied on supply of both goods and services. Therefore, after establishing that an activity falls within the four corners of the term 'supply',

the taxpayer needs to first classify the supply as supply of goods or supply of services with the help of the relevant definitions provided in section 2 and scheme of classification provided in Schedule II to section 7 of the CGST Act, 2017. Once it is established that the particular activity is supply of goods, the classification, as mentioned above, is determined basis Chapters 1 to 98 of Customs Tariff.

However, if the activity is classified as supply of services, the Customs Tariff does not provide any aid in classification of services as it does not have any Chapter to cover services. Therefore, service codes (tariff) for services are provided by way of a 'Scheme of Classification of Services' given as an Annexure to *Notification No. 11/2017-Central Tax (Rate) dated 28.06.2017*, which is the rate notification for services. The said Annexure contains entries under Chapter 99 as also the Explanatory Notes

to provide guidance for interpreting the said entries. It may be noted that there is no Chapter 99 for services in the Customs Tariff.

The Scheme of Classification of Services under GST along with the Explanatory Notes are based on United Nations Central Product Classification. The Preface to the Scheme of Classification of Services under GST lays down that where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description. *Notification No. 12/2017 CT (R) dated 28.6.2017*, which enlists the services that are exempt from GST and *Notification No. 13/2017 CT (R) dated 28.6.2017*, which enlists the services, GST on which is payable under reverse charge, also make use of the service codes as provided in Scheme of Classification of Services under GST.

To summarise the discussion, accurate classification of goods and services is vital for determining the correct GST liability. Classification can be done accurately by following the Rules of Interpretation in case of goods and Explanatory Notes to the Scheme of Classification in case of services; logical understanding, common sense or experience alone would not suffice for determining the correct classification of goods and services. Classification is not only relevant for ascertaining the rates of tax, but also the availability of exemptions and taxability under reverse charge. Appropriate classification is *sine qua non* to avoid legal disputes and demands from the tax authorities. ■■■

