

Classification of Goods under GST Regime



In any indirect tax, classification of goods is very vital. The same has very wide implications particularly in case of multi rate tax structure like GST as we are aware that classification of goods under CGST Act, IGST Act and respective SGST Acts have to be done in accordance with Harmonised System of Nomenclature (HSN). However, a large majority of taxpayers, specially traders, are not familiar with HSN codes even after about one year since the introduction of GST in the country. Classification disputes may result in long drawn legal battles for the tax payer. It may also lead to huge liability in case of adverse decisions. The provision regarding compulsory pre deposits 10% (for first appeal) and a further 20% (in second appeal) of the tax in dispute, itself would require an entity to shell out substantial amount. Therefore, classification of goods should be done with utmost care. Greed to 'forcefully' classify the item under a heading carrying lower tax rate should be completely avoided. Read on to know more...



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Levy

Section 9 of the CGST Act and respective SGST Acts and Sec 5 of IGST Act *inter alia* provides for levy of tax ".....at such rates, not exceeding forty percent, as may be notified by the government on the

recommendation of the council and collected in such manner as may be prescribed

A plain reading of above provision implies that government has power to notify rates of tax on recommendation of GST council. The combined rate of CGST and SGST or IGST (standalone) cannot be more than 40 per cent.

It is pertinent to point out that the charging section does not refer to HSN Code in any manner.

Notification of Rate of Tax

The Central government on recommendation of GST council has notified rate of Integrated tax payable on goods vide notification no. 01/2017 – Integrated tax (rate) dated 28/06/2017. It may be noted that notifications regarding central tax (CGST) issued by central govt and notification regarding state tax (SGST) issued by respective state govt have identical provisions. The notification 01/2017 – integrated tax (rate) dated 28/06/2017 has been taken as basis for discussion. The said notification has been amended from time to time by the government. As on date the said notification divides all goods into following schedules.

Schedule	Rate of tax	No. of entries (excluding deleted entries)
I	5%	303
II	12%	254
III	18%	591
IV	28%	51
V	3%	17
VI	0.25%	5

Notification of Exempted Goods

The goods exempted from IGST have been separately notified vide Notification no. 02/2017 Integrated (Rate). The notification has 156 entries (excluding deleted entries). It is needless to say notifications having identical exemptions have been notified by Central government and respective State governments.

Legal Provisions Regarding Applicability of HSN Codes

As already discussed, the Charging section does not refer to HSN codes in any manner. However, the schedules in notifications issued by respective government as discussed above, has reference to chapter, heading, sub heading and tariff items.

Explanation at the end of each of the above notifications *inter alia* provides

“Tariff item”, “sub-heading” “heading” and “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).

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.

Therefore, it is implied by virtue of above explanation, the classification of goods has to be done in accordance with Customs Tariff Act 1975. However, once the heading/tariff item is arrived at, the rate of GST would be governed by above notifications.

The Customs Tariff Act 1975 is based on HSN. The Customs Tariff Act 1975 is amended from time to time so as to align the same with HSN Tariff developed by world customs organisation. The latest amendments were made by section 141 of Finance Act 2016 to align the Customs Tariff Act to HSN 2017.

Harmonised System of Nomenclature (HSN)

The Harmonised Commodity Description and Coding System generally referred to as "Harmonised System" or simply "HS" is a multipurpose international product nomenclature developed by the World Customs Organization (WCO). It is also referred to as "Harmonised System of Nomenclature" or HSN.

It comprises about 5,000 commodity groups; each identified by a six digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification.

The system is used by more than 200 countries and economies as a basis for their Customs tariffs and for the collection of international trade statistics. Over 98% of the merchandise in

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international trade is classified in terms of the HS. (source: world customs organization official website www.wcoomd.org).

It is also extensively used by governments, international organisations and the private sector for many other purposes such as internal taxes, trade policies, monitoring of controlled goods, rules of origin, freight tariffs, transport statistics, price monitoring, quota controls, compilation of national accounts, and economic research and analysis. The HS is thus a universal economic language and code for goods, and an indispensable tool for international trade.

Meaning of Chapter/heading/Sub heading/Tariff item

- a) **Chapter:** The Custom Tariff Act 1975 is divided into 21 sections which are further divided into 98 Chapters. The first two digits of 8 digit HSN code denotes the chapter under which it falls.
- b) **Heading:** Each chapter is further divided into various “headings” accompanied by a four digit number. Thus, first four digits of an 8 digit HSN code denotes the heading under which it falls.
- c) **Sub Heading:** Each heading is further divided into various “sub headings” accompanied by a six digit number, thus first 6 digits of an 8 digit HSN codes denote the sub heading under which it falls. The international HSN only have 6 digit coding.
- d) **Tariff Item:** Each Sub heading is further divided into various “tariff items” accompanied by a eight digit number, thus all 8 digits of HSN code denotes the tariff item. The last 2 digits of HSN is added by respective countries to cater to local needs.

Rule of Interpretation

The rules of Interpretation of Customs Tariff are as follows:

- 1) The titles of Sections, Chapters and sub-chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and, provided such headings or Notes do not otherwise require, according to the following provisions:
 - a) Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished articles has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or failing to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled.
 - b) Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of rule 3.
- 2) When by application of rule 2(b) or for any other reason, goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as follows:
 - a) The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to only part of the materials or substances contained in mixed or composite goods or to only part of the items in a set





put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.

- b) Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to (a), shall be classified as if they consisted of the material or component which gives them their essential character, in so far as this criterion is applicable.
 - c) When goods cannot be classified by reference to (a) or (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration.
- 3) Goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin.
- 4) In addition to the foregoing provisions, the following rules shall apply in respect of the goods referred to therein:
- a. Camera cases, musical instrument cases, gun cases, drawing instrument cases, necklace cases and similar containers, specially shaped or fitted to contain a specific article or set of articles, suitable for long-term use and presented with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This rule does not,

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however, apply to containers which give the whole its essential character.

- b. Subject to the provisions of (a) above, packing materials and packing containers presented with the goods therein shall be classified with the goods if they are of a kind normally used for packing such goods. However, these provisions do not apply when such packing materials or packing containers are clearly suitable for repetitive use.
- 5) 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 headings, 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.

Common Parlance Test

In case an item or term is not statutorily defined in taxing statute then ordinary meaning according to the common parlance would prevail over scientific or technical meaning. (*CCE Kanpur vs. Krishna Carbon Paper CO 1988 (37) ELT 480 (SC)*). For example, “soft serve” dispensed through vending machines is understood to be ice cream by a common consumer hence classifiable under heading 2105 *ibid* ice creams and not under 0404 dairy products. (*CCE New Delhi vs. Connaught Plaza Restaurant (p) Ltd 2012 (286) ELT 321 (SC)*).

Resort to Judicial Ruling in Matters of Customs and Excise

Central Excise Tariff Act 1985 and Customs Tariff Act 1975 both are based on HSN. Judicial Rulings pronounced with respect to classification under these two Acts would apply *mutatis mutandis* to classification under GST regime. Therefore, reference should be made to cases under these acts for arriving at proper classification under GST.

Residual Entry

The last entry in Schedule III of Notification no. 01/2017 Integrated Tax (Rate) dated 28/06/2017 is very important and hence requires special attention.

S. No.	Chapter/Heading/ Sub-heading/ Tariff item	Description of Goods
453	Any chapter	Goods which are not specified in Schedule I, II, IV, V or VI

Since the entry refers to 'any chapter', therefore, any goods which are classifiable under any Chapter of Customs Tariff Act 1975 but do not fall in any other entry of schedule III, or any entry of the other five schedules, would be taxable at the rate of 18% (IGST).

How to Arrive at Rate of GST Payable

Step 1:

Find HSN code of the goods according to Customs Tariff Act 1975 arrive at tariff item or at least sub heading under which goods fall. Rules of interpretation of Customs Tariff Act 1975 would be prevalent in case of ambiguity or confusion.

Step 2:

Search each schedule of the notification of rates by rate i.e 01/2017 –IGST. Following points must be kept in mind

- a) that several entries in schedules of rate notification are accompanied only by the chapter number, while some entries are accompanied by heading or sub heading, only few entries are accompanied by full 8 digit tariff item.
- b) The same chapter no., heading, sub heading appears in more than 1 schedule, however, the description of goods differ. In some cases, exclusions are given in the description.

Goods should be classified in the entry which has most specific description. Also, search the exemption notification to check if goods have been exempted.

The classification of goods under GST regime has to be done in accordance with Customs Tariff Act 1975, which is in turn based on Harmonised System of Nomenclature popularly known as HSN.

The rules of interpretation, section notes and chapter notes as specified under Customs Tariff Act 1975 are also applicable for classification of Goods under GST regime.



Step 3:

If goods cannot be classified in any of the entries of any schedule but are classifiable in any chapter as per customs tariff act 1975 then goods will fall under entry 453 of schedule III and will be taxable at the rate of 18% .

Step 4:

If goods cannot be classified under Customs Tariff Act but there is entry in schedule of rate notification which does not refer to any chapter/heading/sub heading/tariff item and the description matches with the goods, the goods would be classifiable under that entry, for example lotteries which cannot be classified under Customs Tariff Act 1975 but falls under entry 242 of schedule II.

Conclusion

The classification of goods under GST regime has to be done in accordance with Customs Tariff Act 1975, which is in turn based on Harmonised System of Nomenclature popularly known as HSN. The rules of interpretation, section notes and chapter notes as specified under Customs Tariff Act 1975 are also applicable for classification of Goods under GST regime. However, once an item is classified in accordance with Customs Tariff Act 1975, the rate of tax applicable would be arrived at on the basis of notifications issued under GST by respective governments. ■