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Classification of Goods or Services

Objectives and Importance of this chapter –

In order to apply a particular rate of tax, a taxable person need to determine the classification of his supply as to whether supply constitute a supply of goods or services.

Once the same is determined, further classification in terms of HSN (Harmonised System of Nomenclature) in case of goods and SAC (Services Accounting Codes) in terms of service is to be made by the assessee so as to arrive at the rate of tax at which he is required to pay tax.

General Information –

It is important to note that HSN for goods are contained in Chapters from 1 to 98 and HSN for Services are contained in Chapter 99.

The steps for determination of proper classification is as under:

1. It is important to note that classification of each product supplied has to made separately if supply of such product is independent. This shall include all by products, scraps etc.
2. Identify the description and nature of the goods being supplied. One must confirm that the product is also similarly or more specifically covered in the Customs Tariff and HSN 2017. The Section, Notes and Chapter Notes to the Schedule to be read.
3. If there is ambiguity, first reference shall be made to the Rules for interpretation of the Customs Tariff, which are:
 - Rule 1: heading are for reference only and do not have statutory force for classification
 - Rule 2(a): reference to an article in an entry includes that article in CKD-SKD condition
 - Rule 2(b): reference to articles in an entry includes mixtures or combination
 - Rule 3(a): where alternate classification available, specific description to be preferred
 - Rule 3(b): rely on the material that gives essential character to the article
 - Rule 3(c): apply that which appears later in the tariff as later-is-better
 - Rule 4: examine the function performed that is found in other akin goods
 - Rule 5: cases-packaging are to be classified with the primary article
 - Rule 6: when more than one entries are available, compare only if they are at same

Errors in GST classification – Impact

Many assessee could suffer loss of business in period of uncertainty till proper classification is arrived at as they may have adopted some rate for their supplies as they could not afford to stop. After that they may be following the same unless there is any objection. The cost of errors would include the following:

1. In case of higher tax charged, assessee may have to suffer the loss of orders and cost of re-establishing business with the customers, the loss of credibility with customers. The cost of discounts due to incorrect rate is not factored which one is forced to give to retain the customer.



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2. In case of goods or services supplied which are nil rated or exempted the denial of credit by the revenue up to 5 years can be fatal for the business. Demands maybe made at multiple stages of the supply chain. This is a major departure from the earlier regime.
3. In case of short charge due to incorrect classification or claim of exemption which is not available, would result in non-recoverability of taxes from the customers and cost of interest. In business, breaking the credit chain could make business unviable.
4. Valuation methods prescribed for certain categories of goods and or services would be dependent on the classification of such goods and/or services. Wrong classification would lead to wrong payment of tax.
5. On certain goods and/or services GST is to be discharged by the recipient of supply under reverse charge mechanism. Wrong classification may result in non-payment of tax or un-necessary payment of tax.
6. Denial of benefits under FTP such as duty drawback and incentives being provided for various goods and/or services at varied rates can be the result.
7. Non-payment of compensation Cess, if any, applicable on specified goods and or services which may result in penal proceedings
8. Getting the liability on Import of goods/Services all wrong or not claiming the ITC (Input Tax Credit) benefit of export on goods/service exports due to improper classification could also happen. This could happen when the alternative headings available have different import/export criterion being applicable to them.

Rate of tax for goods or services

Purpose of Notification	Supply of Goods	Supply of Services
Prescribing the rate of tax	1/2017-Central Tax (Rate) (As amended from time to time)	11/2017-Central Tax (Rate) (As amended from time to time)
Granting the exemption	2/1017-Central Tax (Rate) (As amended from time to time)	12/2017-Central Tax (Rate) (As amended from time to time)