

Chapter-III A

Classification and Exemption

Introduction

GST law does not contain a commodity classification tariff but are contained within the notification which prescribes the rate of tax. Classification therefore, is an exercise that is inevitable to identify the specific entry in any of the 6 schedules for determining the rate of tax on the supply of goods or services. The revenue department could object to the rate adopted or exemption claimed when the error is observed at the time of assessment, investigation or revenue audit. This could lead to multiple demands at all stages of supply and also denial of credit. The customer may object to the classification or the rate. The assessee himself may come to know of the error due to competitors using different rates, paying or not paying, attending some awareness session, reading articles, books. Errors may also come to light at the time of due diligence, internal audit, statutory audit, outsourced consultant changing, etc.

Errors in GST classification – Impact

Many assessees 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.
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.

In case of revenue raising the short charge or ineligible exemption issues, in addition to the above costs: the cost of penalty, denial of credit availed, cost of dispute resolution at adjudication, appeal, Court stages also would arise. It should be kept in mind that the internal manpower resources could get substantially involved to resolve the issue inspite of the fact that a specialist in GST may be outsourced to prepare the reply, appearance etc.

Analysis

i. Classification of Goods or Services:

In order to apply a particular rate of tax, one needs to determine the classification of the supply as to whether the supply constitutes a supply of goods or services or both. Once the same is determined in terms of Section 7 and 8, a further classification in terms of HSN of goods and services has to be made so as to arrive at the rate of tax applicable to the supply. At the outset, it is important to note that HSN for goods are contained in Chapters from 1 to 98 and HSN for Services are contained as Chapter 99 Notified as the 'Scheme of Classification of Services' provided as an Annexure to the Notification issued for rate of tax (CGST) applicable to services (i.e., Annexure to Notification No. 11/2017-Central Tax (Rate) dated 28.06.2017).

The Classification of Goods is older and is based on knowledge gathered from precedents on HSN classification, as an adaptation from that formulated by the World customs Organisation. The suggested steps for determination of proper classification of goods are as under:

1. The classification of each supply has to be made separately for every individual supply, regardless of the form of supply (such as sale / transfer / disposal including by-products, scraps etc.)
2. Identify the description and nature of the goods being supplied. One must confirm that the product is also more specifically covered in the Customs Tariff. The Section Notes and Chapter Notes specified in the Customs Tariff would squarely apply to the Tariff Schedules under the GST Law, and ought to be read as an integral part of the Tariff for the purpose of classification.
3. If there is any ambiguity, first reference shall be made to the 'Rules of Interpretation' of the First Schedule to the Customs Tariff Act 1975.

- (a) As per the Rules, first step to be applied is to find the trade understanding of the terms used in the Schedule, if the meaning or description of goods is not clear.
 - (b) If the trade understanding is not available, the next step is to refer to the technical or scientific meaning of the term. If the tariff headings have technical or scientific meanings, then that has to be ascertained first before the test of trade understanding.
 - (c) If none of the above are available reference may be had to the dictionary meaning or ISI specifications. Evidence may be gathered on end use or predominant use.
4. In case of the unfinished or incomplete goods, if the unfinished goods bear the essential characteristics of the finished goods, its classification shall be the same as that of the finished goods.
 5. If the classification is not ascertained as per above point, one has to look for the nature of goods which is more specific.
 6. If the classification is still not determinable, one has to look for the ingredient which gives the goods its essential characteristics.

ii. **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)

A screenshot of the website hosted by the Central Board of Indirect Taxes and Customs (CBIC – Source link: <http://www.cbic.gov.in/htdocs-cbec/gst/central-tax-rate-notfns-2017>) containing the list of notifications is provided below:

Central Tax (Rate) Notifications			
Notification No. & Date of Issue	English	हिन्दी	Subject
07/2017-Central Tax (Rate), dt. 28-06-2017	View (254 KB)	देखें (512 KB)	Exemption from CGST supplies by CSD to Unit Run Canteens and supplies by CSD / Unit Run Canteens to authorised customers notified under section 11 (1) and section 55 CSD
06/2017-Central Tax (Rate), dt. 28-06-2017	View (142 KB)	देखें (498 KB)	Refund of 50% of CGST on supplies to CSD under section 55
05/2017-Central Tax (Rate), dt. 28-06-2017	View (269 KB)	देखें (685 KB)	Supplies of goods in respect of which no refund of unutilised input tax credit shall be allowed under section 54 (3)
04/2017-Central Tax (Rate), dt. 28-06-2017	View (263 KB)	देखें (739 KB)	Reverse charge on certain specified supplies of goods under section 9 (3)
03/2017-Central Tax (Rate), dt. 28-06-2017	View (299 KB)	देखें (859 KB)	2.5% concessional CGST rate for supplies to Exploration and Production notified under section 11 (4)
02/2017-Central Tax (Rate), dt. 28-06-2017	View (375 KB) Corrigendum (100 KB) Corrigendum (249 KB), dated 27-07-2017	देखें (858 KB) Corrigendum (100 KB) Corrigendum (234 KB), dated 27-07-2017	CGST exempt goods notified under section 11 (1)
01/2017-Central Tax (Rate), dt. 28-06-2017	View (1506 KB) Corrigendum (252 KB), dated 30-06-2017 Corrigendum (100 KB), dated 12-07-2017 Corrigendum (257 KB), dated 27-07-2017	देखें (3398 KB) Corrigendum (488 KB), dated 30-06-2017 Corrigendum (85 KB), dated 12-07-2017 Corrigendum (333 KB), dated 27-07-2017	CGST Rate Schedule notified under section 9 (1)

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Central Tax (Rate) Notifications			
Notification No. & Date of Issue	English	हिन्दी	Subject
18/2017-Central Tax (Rate), dt. 30-06-2017	View (136 KB)	देखें (37 KB)	Seek to reduce the rate of Central Tax, Union Territory Tax, on fertilisers from 6% to 2.5% and Integrated Tax rate on fertilisers from 12% to 5%
17/2017-Central Tax (Rate), dt. 28-06-2017	View (136 KB)	देखें (585 KB)	To notify the categories of services the tax on intra-State supplies of which shall be paid by the electronic commerce operator
16/2017-Central Tax (Rate), dt. 28-06-2017	View (344 KB)	देखें (385 KB)	To notify specialised agencies entitled to claim a refund of taxes paid on the notified supplies of goods or services or both received by them under CGST Act
15/2017-Central Tax (Rate), dt. 28-06-2017	View (142 KB)	देखें (431 KB)	To notify the supplies not eligible for refund of unutilised ITC under CGST Act
14/2017-Central Tax (Rate), dt. 28-06-2017	View (248 KB)	देखें (318 KB)	To notify the supplies which shall be treated neither as a supply of goods nor a supply of service under the CGST Act
13/2017-Central Tax (Rate), dt. 28-06-2017	View (274 KB)	देखें (722 KB)	To notify the categories of services on which tax will be payable under reverse charge mechanism under CGST Act
12/2017-Central Tax (Rate), dt. 28-06-2017	View (440 KB)	देखें (990 KB)	To notify the exemptions on supply of services under CGST Act
11/2017-Central Tax (Rate), dt. 28-06-2017	View (369 KB) Annexure (252 KB)	देखें (11.11 MB) Annexure (252 KB)	To notify the rates for supply of services under CGST Act
10/2017-Central Tax (Rate), dt. 28-06-2017	View (1149 KB)	देखें (503 KB)	CGST exemption for dealers operating under Marginal Scheme notified under section 11 (1)
09/2017-Central Tax (Rate), dt. 28-06-2017	View (143 KB)	देखें (500 KB)	Exempting supplies to a TDS deductor by a supplier, who is not registered, under section 11 (1)

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iii. Requirement of Classification

It may seem like classification may not be so cumbersome, and experience, logic and common sense are sufficient tools to identify the classification, and to interpret the tariff notifications. However, a quick look at some examples would drive home the need to pay close attention to the principles of classification. Let us consider the following examples:

- (1) a 'watch made of gold' – an article of gold or a watch, albeit an expensive one?
- (2) a confectionary product 'hajmola' – an ayurvedic medicaments or remains confectionary sweets?
- (3) serving of 'brandy with warm water' – classified based on its curative effect on common cold, or dismissed as alcoholic liquor for human consumption?
- (4) surgical gloves – latex products or accessories to healthcare services?
- (5) mirror cut-to-size for automobiles – article of glass or accessories to motor vehicles fitted as rear-view mirror?

As can be seen from the few instances mentioned above, classification is not one that is free from doubt. When coupled with differential rates of tax, the scope for misclassification would be reinforced with motivation to either reduce the tax incidence / or to pay a higher tax to circumvent any possible interest and penalty. Both these motivations can work on either sides – industry as well as tax administration. Classification cannot, therefore, be left to the whims and fancies of each person, and reference must be had to the guidance provided in the law itself.

iv. **Approach to Classification**

The notifications prescribing the rate of tax in respect of goods as well as services contain explanations as to how the classification must be undertaken. Extracts of some of those explanations are provided below for ease of reference:

(iii) “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).

Notification 1/2017-Central Tax (Rate) dated 28 June, 2017

4. *Explanation.-* For the purposes of this notification,-

(i) Goods includes capital goods.

(ii) Reference to “Chapter”, “Section” or “Heading”, wherever they occur, unless the context otherwise requires, shall mean respectively as “Chapter, “Section” and “Heading” in the annexed scheme of classification of services (Annexure).

(iii) The rules for the interpretation of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975), 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 heading 9988.

(iv) Wherever a rate has been prescribed in this notification subject to the condition that

Notification 11/2017-Central Tax (Rate) dated 28 June, 2017

As can be seen from the above, the notification prescribing the rate of tax itself specifies the approach that is to be followed for purposes of classification, namely:

- (a) in respect of goods, the notification requires reference to be had to the First Schedule to Customs Tariff Act 1975: A quick look at these helps is to recognize the approach that needs to be followed for classification.

1. THE CUSTOMS TARIFF ACT, 1975 (51 OF 1975)¹

(1)

An act to consolidate and amend the law relating to customs duties.

Be it enacted by Parliament in the Twenty-sixth Year of the Republic of India as follows:-

1. (1) This Act may be called the Customs Tariff Act, 1975.

(2) It extends to the whole of India.

(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.^{2,3}

2. The rates at which duties of customs shall be levied under the Customs Act, 1962, are specified in the First and Second Schedules,⁴

The above table is an adaptation of the Harmonized System of Nomenclature (HSN) established for aiding in uniformity in Customs classification in international trade between member countries of World Customs Organization. It was drafted under the aegis of Customs Cooperation Council Nomenclature, Brussels. It was adopted for Customs purposes by India in 1975 and readapted (with some changes) for Central Excise in 1985 and now for purposes of GST in 2017. Please bear in mind that reference to the original HSN would be of much help in understanding the scope of any entry to understand the full extent of meaning implied in any entry found while reading Customs Tariff Act. Refer www.wcoomd.org where the HSN is available for purchase or subscription from World Customs Organization.

- (b) in respect of services, the notification requires reference to be had to the Annexure which contains the Scheme of Classification: The Annexure is appended to the CGST rate notification and contains entries under Chapter 99 (although there is no such chapter for services in the HSN prescribed under the Customs Law):

1. THE CUSTOMS TARIFF ACT, 1975 (51 OF 1975)¹




An act to consolidate and amend the law relating to customs duties.

Be it enacted by Parliament in Twenty-sixth Year of the Republic of India as follows:-

1. (1) This Act may be called the Customs Tariff Act, 1975.

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14/2017-Central Tax (Rate) ,dt. 28-06-2017	View  (248 KB)	देखें  (318 KB)
13/2017-Central Tax (Rate) ,dt. 28-06-2017	View  (274 KB)	देखें  (722 KB)
12/2017-Central Tax (Rate) ,dt. 28-06-2017	View  (440 KB)	देखें  (990 KB)
11/2017-Central Tax (Rate) ,dt. 28-06-2017	View  (399 KB)	देखें  (1.11 MB)
	Annexure  (252 KB)	Annexure  (252 KB)
10/2017-Central Tax (Rate),dt. 28-06-2017	View  (143 KB)	देखें  (503 KB)
09/2017-Central Tax (Rate),dt. 28-06-2017	View  (143 KB)	देखें  (500 KB)

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- v. In this regard, it may also be noted that the tariff entries in case of certain services, make reference to the rate of tax applicable to the relevant goods. In the following cases of supply of services, the rate of tax applicable as on a supply of like goods involving transfer of title in goods, would be applicable on the supply of services:

Chapter, Section or Heading	Description of Service
Heading 9971 (Financial and related services)	(ii) Transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.
	(iii) Any transfer of right in goods or of undivided share in goods without the transfer of title thereof.
Heading 9973 (Leasing or rental services, with or without operator)	(iii) Transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.
	(iv) Any transfer of right in goods or of undivided share in goods without the transfer of title thereof.
	(vi) Leasing or rental services, with or without operator, other than (i), (ii), (iii), (iv) and (v) above.

The only exception to the above table is leasing of motor vehicle which was purchased by the lesser prior to July 1, 2017, leased before the GST appointed date (i.e., 01.07.2017 and no credit of central excise, VAT or any other taxes on such motor vehicle had been availed by him. If all these conditions are fulfilled, then the lessor is liable to pay GST only on 65% of the GST applicable on such motor vehicle. – Refer notification No.37/2017- Central Tax (Rate) dated 13.10.2017.

vi. Customs Tariff Act – Rules of Interpretation:

The rules of interpretation are contained in the Customs Tariff Act provides guidance regarding the approach to be followed for reading and interpreting tariff entries. These rules are merely summarized and listed below for convenience, whereas a detailed study of the rules is advised from commentaries and value added updated tariff publications. Please refer to full set of Rules of Interpretation at page 28 and 29 of the Customs Tariff Act on <http://www.cbec.gov.in/resources/htdocs-cbec/customs/cst2012-13/cst-act-1213.pdf>

- ✓ Rule 1: headings 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 level.

vii. Role of 'Manufacture' in Classification

Classification would be well understood by applying the above rules of interpretation. Now, the process that goods are passed through can impact their classification. For example, cutting, slicing and packing pineapple in cans in sugar syrup has primary input is pineapple and the output is canned fruit with extended shelf-life. Now, the input and output are not identical but it has held in the case of Pto Food Packers that this is not a process amounting to manufacture. But, would it be possible to regard the input and the output to retain the same classification. The answer lies in knowing the scope of each entry applicable to classification. Another example, kraft paper used to make packing

boxes may be sold as it is or after laminating them. It has been held in the case of Laminated Packaging that this process is manufacture even though the input and output fall within the same classification entry. GST Law has adopted, in section 2(72), the general understanding of manufacture that is very similar to that in Central Excise. The real test from this definition – is the input and output functionally interchangeable or not in the opinion of a knowledgeable end-user – and not based on the classification entry. Change in classification entry from one to the other, that is, classification entry for input is not the same as that of the output, could only arouse suspicion about the possibility of manufacture. Please note that ‘manufacture’ is included in the definition of ‘business’ (in section 2(17)) but it is not included as a ‘form of supply’ (in section 7(1)(a) or anywhere else). Hence, the nature of the process that inputs are put through may not be manufacture but yet may appear to move the output into a different entry compared to the input. So, would change of classification entry be relevant or degree of change produced in the input due to the process carried out must be considered. With the adoption of HSN based classification from Custom Tariff Act, it is imperative to carefully consider whether one entry has been split and sub-divided into categories even if they both carry the similar rate of tax. Hence, the key aspects to consider are:

- Identify the scope of an entry for classification of input or output
- Study the nature of process carried out on the inputs
- Examine by the ‘test’ (above) if result of the process is manufacture
- Now identify the classification applicable to the output

For example, is ‘desiccating a coconut’ a process of manufacture? If yes, the desiccated coconut ought not to be considered as eligible to the same rate of tax as coconut. Drying grains may not appear to be a process of manufacture but frying them could be manufacture as the grains are no longer ‘seed grade’ although it resembles the grain.

Manufacture need not be a very elaborate process. It can be a simple process but one that brings about a distinct new product – in the opinion of a knowledgeable end-use – and not just any person with no particular familiarity with the article. Manufacture need not be an irreversible process. It can be reversible yet until reversed it is recognized as a distinct new product, again, in the opinion of those knowledgeable in it. Processes such as assembly may be manufacture in relation to some articles but not in others. So, caution is advised in generalizing these verbs – assembly, cutting, polishing, etc. – but examining the degree of change produced and the identity secured by the output in the relevant trade as to the functional inter-changeability of the output with the input. If a knowledgeable end-use would accept either input or output albeit with some reservation, then it is unlikely to be manufacture. But, if this knowledgeable end-user would refuse to accept them to be interchangeable, then the process carried out is most likely manufacture. Usage of common description of the input and output does not assure continuity of classification for the two.

viii. Role of 'Supplier Status' in Classification

This is best explained with an illustration – a restaurant buys aerated beverage on payment of GST at 28% +12% including cess and on resale of this beverage as part of food served as a combo with 'composition status' under Section 10 of CGST Act, the rate of tax on this beverage would be 5%. Therefore, it is important to note that classification can undergo a change depending upon the 'status' of the Supplier. Another illustration could be medicaments which are taxed at 5% would be exempt from tax when they are administered by the hospital to casualty/emergency admissions and to in-patients even if billed separately in the invoice issued to patient by the hospital.

ix. Classification for Exemptions

In GST law the exemptions are set out under section 11 of the whole of the tax payable or a part of it. In granting exemptions, it is not necessary that the exemption be made applicable to the entire entry. In other words, exemption notifications are capable of carving out a portion from an entry so as differentially alter the rate of tax applicable to goods or services within that entry. Exemptions can take any of the following forms:

- ✓ Supplier may be exempt – here, regardless of the nature of outward supply, exemption apply to the supplier. Conditions specified may make such exemption be applicable to the supplier but when the supplies are made to specified recipients

Sl. No.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
1	Chapter 99	Services by an entity registered under section 12AA of the Income-tax Act, 1961 (43 of 1961) by way of charitable activities.	Nil	Nil

- ✓ Supplies may be exempt – here, the supplier is not as relevant and all supplies that are notified would enjoy the exemption. Conditions specified may help to determine the supplies that are to be allowed the exemption.

28	Heading 9971	Services by way of— (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services); (b) <i>inter se</i> sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers.	Nil	Nil
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x. Role of 'Conditions' in Exemptions

It is well understood that conditions in exemption notifications tend to convert the exemption into an option, that is, the exempted / concessional rate of tax would apply when the conditions are fulfilled and by deviating from the conditions, the full rate of tax would apply. This principle has been tested in the context of Section 5A of the Central Excise Act. However, a quick look at the Explanation to Section 11 of the CGST Act (reproduced below) appears to indicate that unless an express option is granted in the exemption notification, the concessional or exempted rate of tax along with attendant conditions must be availed without any discretion to opt out of it.

Explanation.—For the purposes of this section, where an exemption in respect of any goods or services or both from the whole or part of the tax leviable thereon has been granted absolutely, the registered person supplying such goods or services or both shall not collect the tax, in excess of the effective rate, on such supply of goods or services or both.

While there may be alternate views that the above explanation applies only when the exemption is 'granted absolutely' and not in all cases, such a view may find the contradiction where one entry in an exemption notification prescribes a concessional rate of tax that applies its restriction on input tax credit, while another entry in the very same notification prescribes two rates of tax where one of them enjoins restriction on input tax credit.

And the reason for resisting the view that – exemption with the condition is an option – is when the Government felt free to specify two alternate tax consequences in respect of a given entry in one case (GTA, in above illustration), there is no justification to make an assumption about the existence of an option even when in the very same notification that government opted to notify only one tax consequence. Accordingly, it would be a reasonable construction that – exemption is a condition is not an option – and all court decisions under earlier laws to the contrary are rendered otiose in view of the explanation to section 11.

Illustration below shows a style where exemption would 'not be option':

Sl No.	Chapter, Section or Heading	Description of Service	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
8	Heading 9964 (Passenger transport services)	(i) Transport of passengers, with or without accompanied belongings, by rail in first class or air conditioned coach.	2.5	Provided that credit of input tax charged in respect of goods used in supplying the service is not utilised for paying central tax or integrated tax on the supply of the service

The following illustration is a style of drafting exemption entries that is 'not optional':

Sl No.	Chapter, Section or Heading	Description of Service	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
		[(vi) Transport of passengers by any motor vehicle designed to carry passengers where the cost of fuel is included in the consideration charged from the service recipient.	2.5	Provided that credit of input tax charged on goods and services used in supplying the service, other than the input tax credit of input service in the same line of business (i.e. service procured from another service provider of transporting passengers in a motor vehicle or renting of a motor vehicle), has not been taken. [Please refer to Explanation no. (iv)]
				or
			6	-] ²⁰] ²¹
		(vii) Passenger transport services other than (i), (ii) (iii), (iv), (v) and (vi) above.	9	-

xi. Conclusion

In light of the foregoing discussion, the following points of learning can be summarized:

- (a) transactions involving goods are, in certain cases, required to be treated as supply

of services. As such, the fundamental classification to be undertaken is the differentiation between goods and services;

- (b) classification of goods and services cannot be made based on logic, experience or common sense. But, recourse to rules of interpretation in the first schedule to Customs Tariff Act is mandatory in relation to classification of goods. And reference to the scheme of classification (contained in the annexure) is inevitable in relation to classification of services. There can be no interchange in the use of the relevant classification rules between goods and services;
- (c) classification in GST requires a deep appreciation of the technical understanding of words and phrases in each domain and any urge to use the common meaning of such words and phrases must be actively discouraged. In other words, even if the common meaning of certain words and phrases appears reasonable, it must be understood that government has deliberately and mindfully words that each and in the case and specific interpretation in the relevant trade;
- (d) classification is not only required to determine the rate of tax applicable but also examine the availability of exemptions. There is no compulsion for an exemption notification to exempt” correctly what is the carveout from an entry a subset of transactions – supplies or suppliers – to attract a different rate of tax;
- (e) exemptions are not optional as are the conditions prescribed in respect of such exemption. Violation of the condition contracts consequences and not options. ‘Absolutely exempt’ does not mean ‘wholly exempt’ and it does not require to be ‘unconditionally exempt’ to be ‘absolutely exempt’.

Common Errors In Classification

The errors/ deliberate action which could lead to exposure should the extent possible be avoided. The errors would include many some of them illustrated below:

- (i) Classifying the supply for lower rate of GST without merit- This maybe due to competition or due to fact that the buyer is unable to avail the credit.
- (ii) Classifying the supply under higher slab to avoid dispute – Though there may not be any demand- customer may have some objection and raise a debit note in future. It lead to higher working capital
- (iii) Classifying under wrong heading considering applicability of the same rate- This may not have any commercial impact as there is no rate difference. However when the rate changes there may be a problem.
- (iv) Classifying the supplies based on convenience of operation – This may not be advisable as it is bound to lead to disputes for self as well as the customers.
- (v) Classifying the supplies incorrectly to claim of exemption – This would also be disastrous as demands if any can cripple the enterprise.

- (vi) Classifying the services considering the place of supply to claim as export etc – This can lead to a) demand for GST as supply is liable b) denial of credit due to time lapse or if longer period invoked and c) Demand for excess refund with interest and penalties.
- (vii) Similar to above classifying differently to avoid Reverse charge mechanism. – This could also lead to demand.
- (viii) Classifying under residuary entry when specific entry or general entry is available.

Conclusion

The proper classification is the foundation to avoid disputes with customers as well as demands from the revenue. The applicability of rates (which have changed in between) and exemptions (have been notified and withdrawn) requires the updated knowledge as well as the information of the past changes. Readers may refer to value added GST Tariff reckoners and commentaries to avoid mistakes.

Statutory Provisions

11. Power to grant exemption from tax

- (1) *Where the Government is satisfied that it is necessary in the public interest so to do, it may, on the recommendations of the Council, by notification, exempt generally, either absolutely or subject to such conditions as may be specified therein, goods or services or both of any specified description from the whole or any part of the tax leviable thereon with effect from such date as may be specified in such notification.*
- (2) *Where the Government is satisfied that it is necessary in the public interest so to do, it may, on the recommendations of the Council, by special order in each case, under circumstances of an exceptional nature to be stated in such order, exempt from payment of tax any goods or services or both on which tax is leviable.*
- (3) *The Government may, if it considers necessary or expedient so to do for the purpose of clarifying the scope or applicability of any notification issued under sub-section (1) or order issued under sub-section (2), insert an explanation in such notification or order, as the case may be, by notification at any time within one year of issue of the notification under sub-section (1) or order under sub-section (2), and every such explanation shall have effect as if it had always been the part of the first such notification or order, as the case may be.*

Explanation.—For the purposes of this section, where an exemption in respect of any goods or services or both from the whole or part of the tax leviable thereon has been granted absolutely, the registered person supplying such goods or services or both shall not collect the tax, in excess of the effective rate, on such supply of goods or services or both.

11.1 Introduction

This provision confers powers on the Central Government to exempt either absolutely or conditionally goods or services or both of any specified description from whole or part of the

central tax, on the recommendations of the Council. It also confers power on the Central Government to exempt from payment of tax any goods or services or both, by special order, on recommendation of the Council.

11.2 Analysis

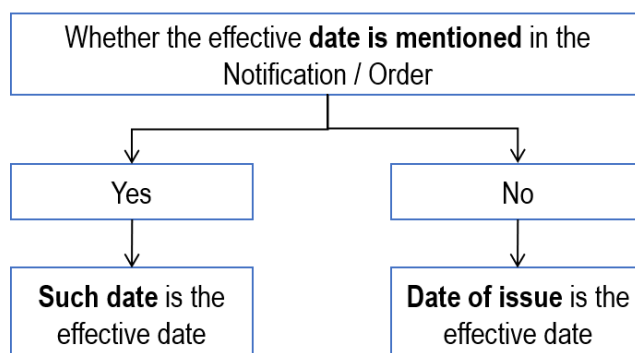
The Central or the State Governments are empowered to grant exemptions from tax, subject to the following conditions:

- (i) Exemption should be in public interest;
- (ii) By way of issue of notification;
- (iii) On recommendation from the Council;
- (iv) Absolute / conditional exemption may be for any goods and / or services of any specified description. In this regard, it may be noted that the exemption would be in respect of the supply and not specifically for any classes of persons. E.g.: An absolute exemption could be granted in respect of supply of water. Whereas, a conditional exemption could be granted for supply of goods to canteen stores department.
- (v) Exemption by way of special order (and not notification) may be granted by citing the circumstances which are of exceptional nature.
- (vi) The GST Law specifies that a registered person supplying the goods and / or services is not entitled to collect a tax higher than the effective rate, where the supply enjoys an absolute exemption.

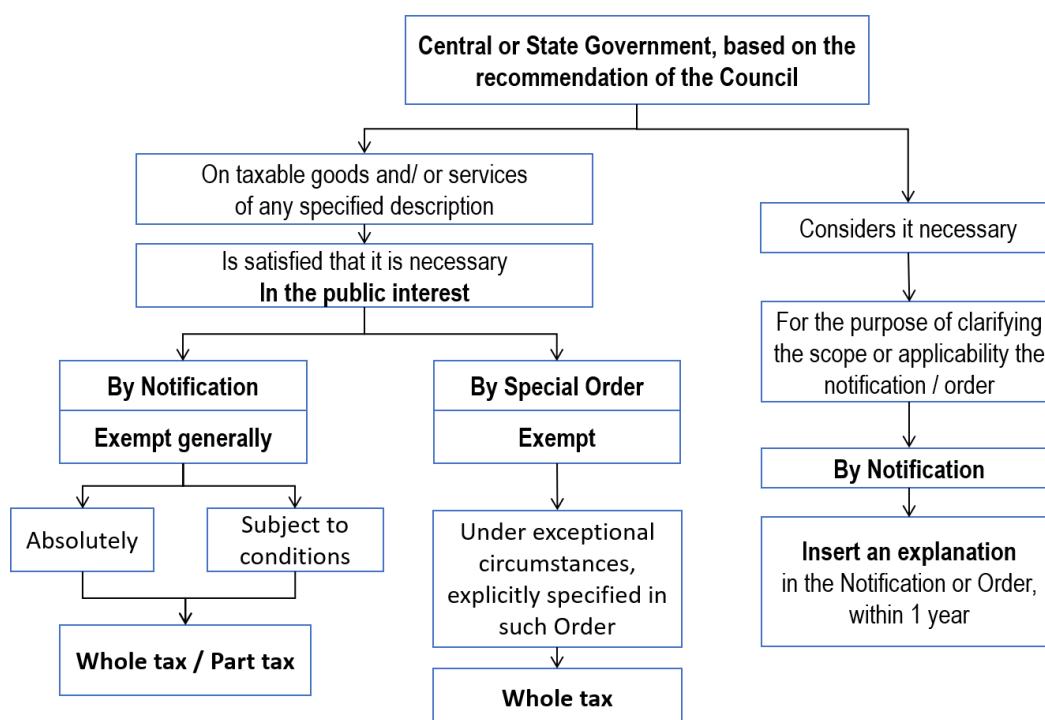
Effective date of the notification or special order:

The effective date of the notification or the special order would be date which is so mentioned in the notification or special order. However, if no date is mentioned therein, it would be:

- Date of its issue for publication in the official gazette;
- Date on which it is made available on the official website of the Government Department.



The analysis of above provision in a pictorial form is summarised as follows:



Exemption under one GST Law and the effect on another GST Law:

An exemption issued under the CGST Act will 'automatically' exempt the same supply from the levy of tax under the SGST/UTGST Act. This is provided under the SGST/UTGST Act. But the converse is not necessarily applicable, that is, exemption under an SGST/UTGST Act will not exempt levy of tax under the CGST Act.

Exemption under CGST Act	Deemed to be exempt under SGST Act
	Deemed to be exempt under UTGST Act
	No auto-application of exemption under IGST Act
Exemption under IGST Act	No auto-application of exemption under CGST Act

Clarification on a Notification / Special Order

The law also provides for the Government to embed a clarification to such notification or special order, by way of an "Explanation", at any time within a period of 1 year from the date of the said notification or special order. Such explanation inserted within the timelines would have a retrospective effect, viz., from the effective date of the relevant notification or special order.

Section 11 – Illustrations

1. Absolute exemption: Exemption to following taxable services from tax leviable thereon:
 - Services by way of renting of residential dwelling for use as residence.

- Services by Reserve Bank of India.
- Services by a veterinary clinic in relation to health care of animals or birds.

Notification No. 12/2017 - Central Tax (Rate) dt.28.06.2017

2. Conditional Exemption: The Central Government has exempted the tax payable under the CGST/ UTGST/ IGST Acts by any taxable person on supply of "Services by a hotel, inn, guest house, club or campsite, by whatever name called, for residential or lodging purposes, having declared tariff of a unit of accommodation less than ` 1000/- per day".

Notification No. 12/2017 - Central Tax (Rate) dt.28.06.2017

3. Conditional, partial exemption: Intra-State supplies of goods or services or both received by a registered person from an unregistered person is exempted from payment of tax under reverse charge provided the aggregate value of such supplies received by a registered person from all or any of the suppliers does not exceed ` 5000/- in a day.

Notification No. 08/2017-Central Tax (Rate) dated 28.06.2017 (Please note that this Notification has been amended by Notification 38/2017-Central Tax (Rate) dated 13.10.2017, and yet again by Notification 10/2018-Central Tax (Rate) dated 25.01.2018).

Glimpse of notifications issued for exemption from payment of tax

Notification No.	Particulars	Comments
02/2017 - Central Tax (Rate) dated 28.06.2017	Exempted supplies of around 149 items of goods in terms of Section 11(1) of the CGST Act, 2017. Ex. Electricity, Salt, fresh fruits, plastic bangles, passenger baggage etc. Amended vide Notification No. 28/2017, 35/2017, 42/2017, 7/2018 - Central Tax (Rate)	
Notification No. 03/2017-Central Tax (Rate) dated 28.06.2017	Goods specified in the List annexed required in connection with various kinds of petroleum operations undertaken are given concessional rate i.e. at the rate of 2.5% under CGST i.e. 5% IGST.	
Notification No. 07/2017-Central Tax (Rate) dated 28.06.2017	Exemption to supplies by CSD to Unit Run Canteens and supplies by CSD / Unit Run Canteens to authorised customers	
Notification No.	Exemption granted from levy of	Exemption in respect of all

Notification No.	Particulars	Comments
08/2017-Central Tax (Rate) dated 28.06.2017	CGST under RCM on supplies received from unregistered persons. (if value of supplies does not exceed ` 5000 from any or all the suppliers in a day) Amended vide Notification No. 38/2017 and 10/2018-Central Tax (Rate) Scope of this exemption has been enhanced to all supplies without any monetary limit, by way of an amendment, upto 31.06.2018.	supplies has been granted up to 31.03.2018 by Notification No.32/2017 dated.13.10.2017. However, given that a notification corresponding to Notification No.08/2017 is missing in the IGST Law, it may be understood that all inter-State supplies remain taxable under Section 5(4) of the IGST Act, 2017 upto 13.10.2017, from which date, all supplies, without any monetary limit, are exempt upto 30.06.018.
Notification No. 09/2017-Central Tax (Rate) dated 28.06.2017	Exemption granted to supplies to a TDS deductor by a unregistered supplier	This exemption notification is not available under IGST (Rate).
Notification No. 10/2017 - Central Tax (Rate) dated 28.06.2017	Exemption to Supplies of second hand goods received by registered person dealing in buying & selling of second hand goods from unregistered person provided the dealer pays central tax on supply of such second-hand goods as per CGST Rules	This exemption notification is not available under IGST (Rate).
Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017	Exemption to supply specified services under the CGST Act. More or less, all the exemptions were available earlier under the erstwhile service tax law Amended vide Notification No. 21/2017, 25/2017, 32/2017 and 47/2017, 2/2018 - Central Tax (Rate)	
Notification No.26/2017-Central Tax (Rate)	Exemption to supply of heavy water and nuclear fuels falling in Chapter 28 of the First Schedule to the Customs Tariff Act, 1975 (51 of	

Notification No.	Particulars	Comments
dated.21.09.2017	1975) by the Department of Atomic Energy to the Nuclear Power Corporation of India Ltd	
Notification No.30/2017-Central Tax (Rate) dated.29.09.2017	Exempting supply of services associated with transit cargo to Nepal and Bhutan	
Notification No.5/2018-Central Tax (Rate) dated 25.01.2018	Exempting the Central Government's share of Profit Petroleum	
Notification No.18/2017-Integrated Tax (Rate) dated 05.07.2017	Exemption from IGST to SEZs on import of Services by a unit/developer in an SEZ	Corresponding Notification would not apply in case of intra-State supplies, given that all supplies by SEZ are inter-State supplies

11.3 Comparative review

The provisions relating to exemption are broadly similar to the exemption provisions under the erstwhile tax regime. There are no significant differences.

11.4 Issues and concerns

1. The law provides that tax shall not be collected at a rate higher than the effective rate of tax applicable on a supply enjoying an absolute exemption. In this regard, there is one school of thought wherein it is inferred that this provision is specific to absolute exemptions only, and in case of conditional exemptions, there is an option available to the registered supplier to collect tax from a recipient (Such a methodology, if adopted by suppliers, would imply that the requirement for input tax credit reversals under Section 17(2) of the Act would not stand attracted). The other view is that the conditional exemptions are not optional, but are mandatory when the conditions relating to the exemption are satisfied.
2. On similar lines, it is to be noted that the restriction imposed by law is upon the "collection" of tax. Therefore, certain registered suppliers may resort to payment of tax without collection thereof, in order to effect only taxable supplies whereby they would not be required to undergo the hassle of reversal of input taxes. However, the issue would arise as regards the documentation. A registered supplier may consider issuing a tax invoice instead of a bill of supply, against a supply that is wholly exempt, and

specifying in the tax invoice prominently, that the recipient is not required to pay the tax charged on the invoice on the basis that the supply is exempted under law. However, this practice is frowned upon, as this methodology is not entirely in compliance with the provisions of the law. It is also important to note that the GST Law casts an obligation on the supplier to prove that he has not collected taxes in such situations.

11.5 FAQs

Q1. When exemption from whole of tax leviable on goods and/or services has been granted unconditionally, can taxable person collect tax?

Ans. No, the taxable person providing goods and/or services shall not collect the tax on such goods and/or services in respect of those supplies which are notified for absolute exemptions.

Q2. Under what circumstances can a special order be issued?

Ans. The Government may in public interest, issue a special order on recommendation of GST council, to exempt from payment of tax, any goods and/or services on which tax is leviable. The circumstances of exceptional nature would also have to be specified in the special order.

11.6 MCQs

Q1. Which of the following can be issued by Central Government/ State Government to exempt goods and/or services on which tax is leviable in exceptional cases?

- (a) Exemption Notification
- (b) Special order
- (c) Other notifications
- (d) None of the above

Ans. (b) Special Order