TAXTRU BUSINESS ADVISORS

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Demystifying the woes of 'Classification'

Topics to be covered

Importance of Correct Classification

Analysis of key judgments

How to deal with the notices/communications from the departmental authorities in respect to Classification issues.

1.
Importance of Correct Classification

You don't pay taxes--they take taxes

Importance of Correct Classification

The term "Classification" is defined as **systematic arrangement** in **groups** or **categories** according to **established criteria**.

Under the given concept, the arrangement of varied items is into **mutually exclusive** but **related classes**.

Importance of Correct Classification

Under the Indirect Tax regimes prevalent across the Globe including India, the classification of various items which are the subject matter of tax, be it goods or services, is an **essential and integral part** of the whole levy and collection mechanism.

It is important both from the taxpayer's perspective and tax collector's perspective to have a definite class or group under which subject matters of tax can be divided.

The primary intention of classifying them is to determine whether or not the same would be encumbered by the levy of these taxes and if so, under which category the tax liability would arise.

Importance of Correct Classification

- Leviability of Tax
- Goods versus Services
- Exemptions
- Rate of Tax
- Standardization and avoiding differentiation

In multiple Tax Rate structure, there is always a certain amount of arbitrage created between the tax payer and the tax collector for classification of items.

Example the tussle to classify items between the rates 18% or 28% shall be always on the cards.

Since the Government in India as explained above, is heavily dependent on the tax collections as its source of revenue, they will always be tempted to classify items at the rate bracket of 28% and for tax payer the situation will be vice-versa.

The 10% gap between the rates opens the flood gates for litigation and divergent interpretations. In fact tax rate gap of 7% between 5% and 12% rates is also significant.

Classification disputes are not new in the Indian Taxation system.

According to an estimate, currently around **11200** cases are pending before the Supreme Court of India which are pure classification issues under erstwhile Central Excise, Service Tax and VAT regime. Hence India has 70 years of History in the disputes over classification of items under tax legislations.

Definition of ‘Goods’ and ‘Services’

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Activities listed in Schedule-II

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Activities listed in Schedule-III

↓

Identification of Composite Supplies or Mixed Supplies

↓

Identification of HSN Code from the rate notification

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Applicability of Principles of Interpretation applicable on Customs Tariff Act 1975 now made applicable vide Notification No 01/2017-CT (Rate) dated 28.06.2017.

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Understanding the Service Code (Tariff) applicable on services in accordance with Annexure to Notification No 11/2017-CT (Rate) dated 28.06.2017

Definition of ‘Goods’ and ‘Services’

The terms ‘goods’ and ‘services’ have been well defined under Section 2 of the respective laws. According to **Section 2(52) of the CGST Act 2017,** the term goods is defined as under: *(52) “goods” means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;*

The term ‘services’ has been defined under Section 2(102) of the CGST Act 2017 thus:

(102) *“services” means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged:*

Why it is important ?

Rules differ for fixation of place of supply, time of supply and valuation under GST for Goods and Services.

Schedule-II - Classification of activities as Supply of Goods or Supply of Services

Drawing power from Section 7(1)(d) of the CGST Act, 2017, certain activities have been treated as supply of Goods or Supply of Services under Schedule –II appended to the Acts.

It is interesting that activities in Schedule-II do not classify any article as goods or services. Rather, it consists of certain activities which can be either treated as supply of goods or supply of services.

There can be a situation where, an item might neither be goods nor services but its supply is treated as supply of service by virtue of Schedule-II **(Example Transactions in Land and Building).**

Hence Schedule-II should be read in isolation since it is qua activity but not qua the item which is subject matter of tax.

Schedule-II - Classification of activities as Supply of Goods or Supply of Services

All the activities in relation to Goods which are constituted within the definition of supply cannot be classified as supply of goods always. In some cases, activities in relation to goods can be treated as supply of services also. (Lease/Transfer of Right)

Activities in relation to neither goods nor services can be still be treated as supply of services.

(Lease of Immovable Property)

Deemed Supply of 'Goods' or 'Services'

(Schedule 1)

Composite Supply and its treatment

Declared Supplies influenced from erstwhile Service Tax provisions.

Classification of Activities which are neither Supply of Goods nor Supply of Services

In contrast to Schedule-II, drawing power from Section 7(2)(a) certain activities have been specified under Schedule-III which are neither treated as supply of goods nor as supply of services.

Hence the given Schedule is also qua activity and not qua item. Since GST is leviable on Supply of Goods or Services, even if any of the items as specified in Schedule-III is either goods or services, by deeming fiction, activity undertaken on it under Schedule-III shall constitute as if no supply has taken place at all in terms of the GST Acts.

Identification of Composite Supplies or Mixed Supplies

In real world, with changing business dynamics, the supplies are also intermingled and entangled. There may be numerous situations wherein two independent supplies are provided together. Such supply can be of goods or services. Various situations which can arise in real world wherein supplies are provided with each other are:-

- Supply of two or more goods together (Machine with Packing)
- Supply of two or more services together (Storage and Transportation)
- Supply of goods with supply of services (Wall Painting with Paint)
- Supply of services with supply of goods (Machine with Installation)
- Supply of goods with supply of neither goods nor services (Exchange of Currency with Sale of Currency)
- Supply which constitutes taxable and exempted supplies together (Sale of Bakery item with Vegetables)
- Supply which constitutes taxable and non-GST supplies together (Sale of Lubricant with Petrol)
- Supply which is taxable and transactions specified in Schedule-III (Sale of Furniture with sale of Building)

Mathuram Agarwal v. State of Madhya Pradesh (1999) 8 SCC 667 (SC)

- It was held by the Supreme Court of India thus: *"The statue should clearly and unambiguously convey the three components of the tax law i.e. the subject of the tax, who is liable to pay the tax and the rate at which the tax is to be paid.*
- *If there is any ambiguity regarding any of these ingredients in a taxation statue then there is no tax in law.*
- *Then it is for the legislature to do the needful in the matter. "*

Card Protection Plan Ltd v. Commissioners of Customs and Excise [2012] 22 taxmann.com 176 (ECJ)

- *Two or more acts to be regarded as a single supply if they are so closely linked that they form a single indivisible economic supply:*
- *Where a transaction comprises a bundle of features and acts, then, whether it constitutes one single supply, or, two or more supplies should be determined taking into account the facts and circumstances of the case.*
- *There may be a single supply where some element(s) constitute the 'principal' supply, while others are 'ancillary'.*
- *Further, if two or more elements or acts supplied by the taxable person to the customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split, then, all those elements would constitute a 'single supply' for the levy of tax.*
- *The fact that a single price is charged for all elements is not conclusive. [Para 18]*

Interesting decisions rendered by European Court of Justice

Aktiebolaget NN v. Skatteverket [2012] 22 taxmann.com 175 (ECJ)

- *Definition of 'Predominant element determines classification' - If service is only a better means of enjoying goods sold, then, service incidental to sale of goods - Cost of elements is also relevant, but, cost alone is not decisive - Assessee entered into a single contract of supply and installation of telecommunication cable across countries.*
- *Property in cable passed to client after cable was installed and tested. The Department demanded service tax contending whole of transaction was 'service'.*
- ***HELD:*** *Supply of Cable and laying thereof are so closely linked that they constitute a single indivisible economic transaction. Predominant element is supply of cable as property in cable is transferred to client without alteration/adaptation to requirement of client and cost of materials is major part of cost.*
- *Since supply of goods element is predominant whole contract is a 'sale' and not service and hence not liable to service tax [Paras 31 to 40] [In favor of assessee]*

Interesting decisions rendered by European Court of Justice

LevobVerzekeringen BV and OV Bank NV v Secretary of State for Finance, Netherlands* [2012] 22 taxmann.com 174 (ECJ) Service

- *Definition of - Under a single contract, basic software supplied, customization carried out and training provided by same supplier - prices were stipulated separately - Department contended that whole transaction amounted to 'supply of service' liable to service tax –*
- ***HELD :*** *All such elements were so closely linked that they constituted a single indivisible economic transaction. Separate pricing was not relevant. Predominant element was customization as only customization would make the software useful to consumer and price thereof was also higher. Since service element viz., customization was predominant, whole contract constituted a 'single supply of service' and was liable to service tax [In favor of revenue]*

Classification of Goods as per Notification

The Central Government, on the recommendations of the GST Council, has issued Notifications Number 01/2017-CT (Rate) dated 28.06.2017 prescribing the Rate of Tax (Schedules) for specified goods under CGST/IGST ("Rate Notification"). This Notification is divided into 6 Schedules, as follows:

(i) 2.5% (Schedule I);
(ii) 6% (Schedule II);
(iii) 9% (Schedule III);
(iv) 14% (Schedule IV);
(v) 1.5% (Schedule V);
(vi) 0.125% (Schedule VI)

Explanation to the Rate Notification No. 1/2017-Central Tax (Rate)

For the purposes of this Notification:

…

(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).

(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.

Broad outline of the Tariff ; Section

SECTION is a grouping of a number of Chapters which codify a particular class of goods. Each Section is related to a broad class of goods, for instance:

Section I : Live Animals

Section IV – Prepared foodstuffs, beverages

Section XII – Footwear, Headgear, Umbrella, Articles of human hair

Broad outline of the Tariff ; CHAPTER

CHAPTER and subchapters contain a particular class of goods, for instance the Section on Prepared foodstuffs, beverages covers Chapters like
Chapter 16: Preparations of meat, fish, etc.
Chapter 17: Sugar and sugar confectionery
Chapter 18: Cocoa and cocoa preparation

Broad outline of the Tariff ; HEADING

Each chapter is further divided into various HEADINGS and subheadings depending upon the different type of goods covered within the Chapter, for instance Sugar and Sugar confectionery is further divided into headings like

a) Cane or beet sugar.
b) Other sugars, molasses (refining of sugar)
c) Other sugar confectionery

Reading the Tariff

It is important to first narrow down the search for the relevant classification by scaling it down to a particular Section or Chapter.

It is interesting to note that the various commodities grouped under the Sections, Chapters, etc are arranged in increasing order of manufacturing process required on the said commodity – for instance, the Tariff begins with natural products, raw materials, goes on to semi- finished goods and concludes with fully manufactured goods.

Reliance is not to be placed solely on the Section or Chapter Titles to classify the product therein.

Reading the Tariff

Once the search has been restricted to a Specific Chapter, each Chapter begins with a set of Notes that are to be interpreted along with various headings in the Chapter.

Such Notes may contain definitions of terms used in the Chapter and specific inclusions and exclusions in the Chapter.

The next portion in the Chapter would comprise a table setting out the Tariff Item, description of goods, Unit, and Rate of duty applicable thereon.

Reading the Tariff

The Indian Tariff System employs the 8-digit format, which is explained below by way of an example

2008 11 00

Heading

Sub-Heading

Tariff Item

Relevance of Dashes

The dashes at the beginning of the description of a group of items indicate the following:

Dashes	Meaning
(-) Single	A group of Goods
(--) Double	Sub-Group
(---) Triple	Sub – Sub Classification

The Mumbai CESTAT in case of **Schnectady Herdillla Ltd v CCE (2007) 208 ELT 110** held that for classification under Tariff headings with double (--) entry before them, the goods have to satisfy specifications of single dash (-) preceding them.

Tariff Item	Description of Goods	Unit	Rate of Duty (Standard)	Rate of Duty (Preferential)
2008	Fruit, nuts and other edible parts of plants, otherwise prepared or preserved, whether or not containing added sugar or other sweetening matter or spirit, not elsewhere specified or included			
	- *Nuts, groundnuts and other seeds, whether or not mixed together*			
2008 11 00	-- Ground nuts	Kg.	30%	–
2008 19	- Others, including mixtures			
2008 19 10	--- Cashew nut, roasted, salted or roasted and salted	g.	45%	–
2008 19 20	--- Other roasted nuts and seeds	g.	30%	–

Heading	Sub-heading	Tariff Item	Unit	Rate of duty

Other facets of the Tariff

The Third Column of the Tariff – "Unit" – indicated by abbreviations – these are mandatory for use in Customs documents, except when impractical (e.g. oil in kgs).

The % sign in Column 4 indicates that duty is charged "ad valorem" on the value of goods.

Only sub-headings at the same level (same dashes) are comparable; for instance, in the above example, cashew nuts, roasted and other roasted nuts is comparable, but cashew nuts and ground nuts are not comparable.

Special provisions in Customs Tariff made applicable to GST Rate Schedule for Goods

Though most of goods are classified as per the above system of HSN, special classification is used in certain cases. Like the following

— All goods imported under “project imports-98.01”
— All laboratory chemicals in packs less than 500 gms or 500 ml-98.02
— All baggage of passengers or member of crew-98.03
— Goods for personal use imported by post or air-98.04
— Stores on board of vessel or aircraft-98.05

These goods will be classified in these headings, irrespective of actual classification as per the Customs Tariff.

Sections & Headings

Each Section and Chapter under the Tariff is accompanied by the notes known as "Section Notes" and Chapter Notes.

These are given at the beginning of the Section or Chapter respectively which governs the concerned Section or Chapter as the case may be. In the case of Section Notes, they are applicable to each Chapter which is part of a specific section of the Tariff.

Classification is to be determined only on the basis of description of the heading read with relevant section or Chapter notes.

Since these notes are part of Tariff itself, these have full statutory backing.

Various Tribunals have held that coverage of respective headings has to be determined in the light of the respective section and Chapter note. Hence in this sense**, the section and Chapter note have overriding force over the respective headings and sub-headings.**

Sections & Headings

In **Fenner (India) Ltd v CCE (1995) 97 ELT 8 (SC),** it was observed that tariff schedule would be determined on terms of headings and any relevant section or Chapter notes.

In **CC. v Sanghavi Swiss Refills P Ltd (1997) 94 ELT 644 (CEGAT),** it was held that section notes and Chapter notes, being statutory in nature, have precedence over functional test of commercial parlance for the purpose of classification

Sections & Headings

In the case of interpretation of an exemption notification also, the Supreme Court in the case of **Gujarat State Fertilizers Co v CCE (1997) 91 ELT 3 SC** laid down the principle in its judgment that Chapter Notes of Chapter of Tariff referred to in the notification have to be read as part and parcel of exemption notification.

Similar stand taken by the Tribunal in the case of **New Holland Tractors v.s CCE (2010) 253 ELT 249 (CESTAT) & CCE v Bharat Metal Industries (1999) 105 ELT 494 (CESTAT)**

HSN and Classification

The HSN Explanatory Notes cannot override and dilute the language under the CTA.

However, in case of ambiguity, resort to the HSN is permissible provided there is no conflict with the Headings, Chapter Notes or Tariff Notes.

In **CCE v. Wood Craft Products Ltd. (1995) 77 ELT 23 (SC),** it was held that as per the Statement of Objects and Reasons of Central Excise Tariff Bill, 1985, the new tariff has been introduced, based on HSN to reduce classification disputes.

Thus, in case of doubt, the HSN is a safe guide for ascertaining the true meaning of any expression used in the Act, unless there is an expressly different intention indicated in the Tariff itself.

HSN and Classification

The HSN Explanatory notes have also been held to have overriding effect over trade parlance in case of **Health India Laboratories v. CCE (2007) 216 ELT 161 (CESTAT) affirmed in (2008) 22) E.L.T. A133 (S.C.)**

At the same time, in the case of **New India Industries Ltd. v. CC, Bombay (1994) 73 ELT 723** it was held that the HSN Explanatory Notes have persuasive value but do not have any **statutory authority.**

Furthermore, in the case of **Consolidated Coin Co. P. Ltd. v CCE (2013) 287 ELT 221 (CESTAT),** the Court observed that US Customs Rulings may be considered for classification disputes, since both US and India follow the HSN based classification.

Department to prove classification

CCE vs. Vicco Laboratories (2005) 179 ELT 17 (SC 3 Member Bench).

The burden of proof that a product is classifiable under a particular Tariff head is on the Department and must be discharged by proving that it is so understood by the consumers of products in common parlance.

Classification of Services as per Notification

- No principles for classification of services have been prescribed under notification for rate or under law for the services. The principles of classification as applicable for Goods cannot be applied on services.
- A clue can be taken from the erstwhile service tax provisions and also from CPC (Central Product Classification) by United Nations Statistical Commission whose list of services is akin to the Annexure to Notification No 11/2017-CT Rate dated 28.06.2017.

Classification of Services as per Notification

- Interestingly, The Central Board for Indirect Tax and Customs issued "Explanatory Notes to the Scheme of Classification of Services" on 12th June 2018 wherein it has been specified that:-
- The Scheme of Classification of Services adopted for the purposes of GST is a modified version of the **United Nations Central Product Classification.**
- The Explanatory notes for the said Scheme of Classification of Services is based on the explanatory notes to the UNCPC. The explanatory notes indicate the scope and coverage of the heading, groups and service codes of the Scheme of Classification of Services.
- These may be used by the assessee and the tax administration as a guiding tool for classification of services.
- However, it may be noted 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

What is CPC (Central Product Classification)?

In the Preface to the document issued by Department of Economic and Social Affairs (Statistical Division) of United Nations in 2015 titled "Central Product Classification-Version 2.1", it has been stated thus :

"The Central Product Classification (CPC) constitutes a complete product classification covering all goods and services. It serves as an international standard for assembling and tabulating all kinds of data requiring product detail, including statistics on industrial production, domestic and foreign commodity trade, international trade in services, balance of payments, consumption and price statistics and other data used within the national accounts. It provides a framework for international comparison and promotes harmonization of various types of statistics related to goods and services"

2.
Rules of Interpretation & Key Judgements

Step-wise approach

In terms of the foregoing, given below is a step-wise approach for classification of goods under GST:

- **Step 1:** Identify the goods that require classification.
- **Step 2:** In the Tariff Schedule, commodities are arranged in increasing order of manufacturing process - Identify the broad Sections and Chapters, the said commodity would fall under
- **Step 3:** By way of application of General Rules of Interpretation, classify the product in terms of the 8-digit-classification
- **Step 4:** Find the relevant sub-heading, as per Step 3. The GST Rate Schedule (along with amending notifications) has specified various rates, grouped under 4-digit or 6- digit-classification. Further, a particular Heading may appear in several Schedules, for example, CTH 2106 [Food preparations not specified elsewhere] —
- **Step 5:** Find the relevant description of heading in GST Rate Schedule and corresponding Rate

Step-wise approach

Logical Steps to be followed at the time of classification under Tariff Schedules

- Whether the Section is not applicable on specific goods?
- If yes, no need to look into any of the Chapters within the said Section.
- Whether the Section is applicable on specific goods
- Whether the Chapter is not applicable on specific goods
- If yes, no need to look into any of the Headings within the said Chapter
- If the Chapter is applicable on specific goods Then, within the Chapter see the description of the Heading which accommodates given Goods.

Rule 1: Classification to be determined per the "Headings"

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.

Classification is to be first tested on the basis of Rule 1. Only if Rule 1 does not resolve the issue, the other Rules are to be looked at sequentially.

General Rules of Interpretation

The Supreme Court in case of **CCE s M/s Simplex Mills Co Ltd (2005) 181 ELT 345 (SC)(3 Member Bench)** held that

Rule-1 gives primacy to the Section and Chapter Notes along with terms of the headings. They should be first applied. If no clear picture emerges then only can one resort to the subsequent rules.

Rule 2(a): Classification of incomplete or un-assembled goods

2.(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 falling to be classified as complete or finished by virtue of this rule), presented un-assembled or dis-assembled.

In another case of **LML Ltd. v. CC (1999) 105 ELT 718 (CEGAT) affirmed in 1999 (107) E.L.T. A119 (S.C)],** it was held that a scooter body unit without engine is classifiable as scooter (CETH 871190).

The Court placed reliance on HSN Explanatory Note for Rule 2(a) which states:

"An incomplete or unfinished vehicle is classified as the corresponding complete or finished vehicle provided it has the essential character of the latter [see Interpretative Rule 2 (a)] as for example:

(A) A motor vehicle, not yet fitted with the wheels or tires and battery.

(B) A motor vehicle not equipped with its engine or with its interior fittings.

(C) A bicycle without saddle and tires. This Chapter also covers parts and accessories which are identifiable as being suitable for use solely or principally with the vehicles included therein, subject to the provisions of the Notes to Section XVII (see the General Explanatory Note to the Section)."

Shivaji Works Ltd. v. CCE (1994) 69 ELT 674 (CEGAT),

It was held that the functional test is the correct test for determining the character of a product, i.e. 'primary function' is 'essential characteristic.' Unless the incomplete product is incapable of functioning like the finished goods, this rule is not applicable.

Goods in SKD or CKD condition

In the case of **CCE s. Scan Machineries, (2009) 234 ELT 282 (CESTAT)** the assessee cleared machinery in a phased manner but paid the entire duty at the time of the first clearance of parts, as per trade practice. The clearance was against a single purchase order. It was held that clearance is of a single machine and not as parts of machine.

In the case of **Tata Motors v. CCE (2008) 222 ELT 289 (CESTAT) affirmed in (2016) 337 E.L.T. A99 (S.C.)]**, it was observed that the expression "as presented" should be given the same meaning as "as cleared." Thus, if different parts were cleared from different units at different points of time, duty cannot be demanded by treating them as motor vehicle chassis in CKD condition.

The same principle may not be applicable for an import entitlement which is specifically meted out to "parts" as held in case of **Union of India v. Tara Chand (1983) 13 ELT 1456 (SC); CC v. Reliance Industries Ltd. (2000) 115 ELT 15**

Rule 2(b): Classification of Mixture or Combinations

(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.

While applying the aforesaid rules, some conflict may arise. For example:

- A mixture or combination containing more than one material may be classified under more than one heading by applying rule 2(b). If it contains two items A and B, one classification may be on the basis of "A" and other on the basis of "B".
- There may be two descriptions which may both be possible

General Rules of Interpretation

In the case of **Dhariwal Industries s. CCE (2014) 304 ELT 585 (CESTAT) maintained in (2015) 319 E.L.T. A123 (S.C.),**

The assessee was manufacturing “Calcutta meetha pan” which was a mixture of various items, primary ingredient being pan leaf. The product contained 70% of dry dates and mixture of spices and sweetener. It was held that classification, as per Rules 2(b) and 3(b), ought to be under “Fruits, Nuts and Other Edible parts” under CETH 20.08 and not as “pan masala.”

Rule 3(a): Prefer the Specific entry over the general entry

3. 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 heading search refer to part only of the materials or substances contained in mixed or composite goods or to part only 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.

General Rules of Interpretation

- In case of **Jyoti Industries v. CCE (2000) 115 ELT 559 (CEGAT),** it was held that Kitchen sink is more appropriately covered under "sanitaryware" (i.e. CTH 7324 [Sanitary ware and parts thereof]) which is a specific description than "household articles of iron and steel" (i.e. CTH 7323 [Household articles of iron and steel]) which is a general description.

- In case of **Dunlop India Ltd v UOI (1983) 13 ELT 1566 (SC)** , it was held that Vinyl Pyridine latex is classifiable as `raw rubber' under Item 39 of the Indian Tariff Act, 1934 and not under Item No. 87 as residuary Item or under Item 82(3) as artificial or synthetic resins. The principle was laid down that "when an article is by all standards classifiable under a specific item in the Tariff Schedule it would be against the very principle of classification to deny it the parentage and consign its residuary item"

General Rules of Interpretation

- In case of Commissioner of **VAT v Taneja Mines (2011) 273 ELT 228 (Delhi)(DB)** it was held that religious picture would mean **pictures used for purpose of religious worship and propagation.**
- The mere fact that the religious pictures are mounted/framed is a matter of irrelevance. Also, the cost of the item is again irrelevant. Frames are nothing more than accessories for safe keeping and do not give any essential characteristics to the goods.
- Hence use of gold in religious pictures which depict divinity is in consonance with the concept of the divine. The use of gold plated nickel foil would add ambience to the pictures and thereby increase its value in the aesthetic sense for a man of religious sentiment and theist views.

Rule 3(b): Essential character test for Mixtures or Composite Goods

(b) Mixtures, composite goods consisting of different material is 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.

General Rules of Interpretation

In the case of **CCE v. INARCO. (2015) 318 ELT 604 (SC)**, it was held that floor tiles containing 13.3% PVC (plastic), 84.9% limestone with plastic as binder is to be classified as 'article of stone, cement' as per the test of 'essential character.

In the case of **Xerox India Ltd. v. CC, Bombay,** citation where the dispute pertained to classification of digital printers, with several functions (fax, copier, etc), reliance was placed on Rule 3(b) to classify the item under CTH 8471 as printer, since printing emerged as the principal function.

In re **Samsung India Electronics P. Ltd. – (2016) 340 ELT 430 (AAR)** it was held that mobile phone with zoom camera is to be classified as a phone, and not as camera, asper its primary function.

In **A V Venkateswaran, Collector of Customs v. Ramchand Subhraj 1983 (13) ELT 1327 (SC**) fountain pens with gold nibs, caps, were held to be classifiable as fountain pens.

However, it is to be noted that the said rule would not apply if the articles have a separate identity. In the case of **CC v. Siyaram Silk Mills (2009) 235 ELT 241 (CESTAT)** where a shirt and tie were sold together, it was held that the set cannot be classified as shirt, and they would be classified as separate items.

Rule 3(c): If both are specific – latter the better

(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.

In case of **Mahindra & Mahindra v. CCE – (1999) 109 ELT 739 (CEGAT),** it was held that if tariff entries 87.03 and 87.04 are **equally applicable,** then goods will be classifiable under 87.04 , as it occurs later in the Tariff.

Rule 4: Akin goods Rule 4 states :

4. 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.

In the case of **CCE vs. KWH Heliplastics Ltd. (1998) 97 ELT 385 (SC),** it was observed that in order to resolve the persisting classification dispute, the relationship of the goods under dispute vis-à-vis the description of the goods under the disputed headings should be ascertained. The relationship with a particular heading depends upon the description, purpose and use of goods. If the relationship is established, goods should be classified where they are akin to the description in the Tariff.

Rule 5: Classification of packing containers and packing materials

5. 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, 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, this provision does not apply when such packing materials or packing containers are clearly suitable for repetitive use.

Rule 6: Goods are comparable at the same level only

6. 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.

In the case of **Needle Roller Bearings v. CCE (2000) 124 ELT 577 (CEGAT); Kanwar Sewing Machine, New Delhi v. CC, Bombay (1983) 12 E.L.T. 804 (C.E.G.A.T.),** it was held that **ball bearings** form part of a machine. Hence, a **part of a ball bearing** is also a part of a machine.

In the case of **Nalanda Manufacturing Co.v. CCE (1998) 102 ELT 289 (Tribunal),** it was similarly held that part of a refill is also a part of a ball point pen.

Trade / Common Parlance Understanding

It was held in the case of **Muller & Phipps (India) c. CCE (2004) 167 ELT 374 (SC)**, that "Prickly Heat powder" is 'medicament' asper common parlance, though for the purpose of Drugs Act and Sales Tax Act, the product has been treated as a drug.

In the case of **CCE v. Connaught Plaza Restaurant P. Ltd (2012) 286 ELT 321 (SC)** , it was held that, qua "Soft-serve", in the absence of a definition of the term "ice cream", it is to be construed as per common parlance, even if under the provisions of Food Adulteration Act, it may not fall within the meaning of ice cream. What matters is the way the consumer perceives the product.

However, it is to be noted that trade parlance is to be examined only if the tariff entry is ambiguous as held in **Nirlon Synthetic Fibres v. UOI (1999) 110 ELT 445 (Bom) (DB)**

Section/Chapter Notes prevail over Trade Parlance

- The classification under the Customs Tariff is not dependent on trade parlance when the parameters are precisely laid down in the Tariff itself, in the description of the Section Notes, Chapter Notes read with the Interpretative Rules, all of which have statutory force.

- In **CCE vs Wood Polymers Ltd (1998)97 ELT 193 (SC)** it was held that classification should be done as per the rules of interpretation contained in the Tariff and not as per trade parlance and commercial understanding.

However this is so if the rules of interpretation give correct and conclusive answer. Otherwise, one has to look at trade parlance.

Section/Chapter Notes prevail over Trade Parlance

OK Play (India) Ltd v CCE 2005 (2005) 180 ELT 300 (SC)(3 Judges Bench) laid down the parameters for classification of goods as under:

- No single universal test can be applied for correct classification. There cannot be static parameter for correct classification.
- HSN along with explanatory notes provide a safe guide for interpretation of an entry.
- Equal importance to be given to Rules of Interpretation of Excise Tariff.
- Functional utility, design, shape and predominant usage have also got to be taken into account while determining classification of an item.
- The aforesaid aids and assistance are more important than names used in trade or common parlance in the matter of correct classification.

Technical meaning prevails in certain cases

In the case of **Akbar Badruddin Jiwani v. CC (1990) 47 ELT 161 (SC),** it was held that if the tariff entry is used in a scientific or technical sense, or when there is conflict between entries in the tariff, common parlance will not prevail.

End Use based/ Functional test Classification

- It has been held in **CCE v. Carrier Aircon Ltd. (2006) 147 STC 421 (SC).** that end use to which a product is put is not determinative of its classification.
- For example, "axle studs" will be classifiable as "screws" even if these are used on motor vehicles as held in **Kwality Sales Corporation v. CCE (1986) 23 ELT 137 (CEGAT).**
- However, the exception to this norm is where classification is asper the function of the relevant goods. In such cases, end use is a relevant factor to determine the classification. For example, it was held that plastic pipes and pipe fittings manufactured with the intention of being used as part of irrigation systems should be classified as parts of irrigation system and not as plastic pipes. **[CCE v. EPC Irrigation (2002) 142 ELT 630 affirmed in (2002) 146 E.L.T. A88]**

Other Factors

- Resort to residuary entry
- Dictionary
- Meaning under other Acts or Standards (e.g. ISI/BIS Standards)
- Advertisements/ Product Literature
- Importance of expert opinion and other evidentiary value
- Importance of ISI specification
- Finance Minister's speech (In some case, Finance Minister in the Finance Bill may make certain reference while introducing the changes. Speech of the Finance Minister represents the manner in which the authorities have understood the change. Therefore, the speech of the Finance Minister can be helpful in deciding the classification as held by the Gujarat High Court in the case of **ECHJAY Industries v. UOI (1988) 34 ELT 42 (Guj)**
- Importance of Trade Notice/Circulars, etc.
- Provision at the relevant time
- Beneficial classification

Litigation

- Classification disputes in customs and excise have taken 20-30 years to be settled by judiciary which are likely to get re-opened under GST in initial stages.
- Some of the outcomes are likely to be based on principles laid down under the current regime but there will be fresh cases given the wider reach of GST and interpretations being taken by various states.
- Litigation may also arise owing to interpretation of composite supplies of goods and services, works contracts.
- How to deal with the notices ?

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Thanks!

ANY QUESTIONS?

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