

12.08.2017

## Importance of Classification

By CA Nagendra Hegde

Classification and Exemptions are two crucial aspects under GST law. They would either make or break any business in long run as the interest and penalty clauses under GST are stringent and deadly.

Department could object to the rate adopted or exemption claimed when mistake or error comes to light in the course of assessment, investigation or revenue audit. 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.

Loss of business in period of uncertainty till proper classification is arrived at. Nobody could have got ready for the numerous rates and exemptions due to the fact that they were announced too late. A period of at least 6 months should have been provided for getting ready. However, those who got ready in May 2017 when list discussed in GST council as released were able to be better prepared and in case of unreasonable rates, represented and got the same corrected before 1st July.

**Cost of mistakes in GST classification 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 with the customers, the loss of credibility with customers. The cost of discounts 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. Non availment of exemption benefit would impact adversely on both sides. One being increase in price to customers and on the other hand the ITC availed on inputs, input services and capital goods would be denied.
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, the 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.

## Hiregange & Associates

5. On certain goods and/or 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 in spite of the fact that a specialist in GST maybe outsourced to prepare the reply, appearance etc.

It is said that a stitch in time saves nine - an old English proverb. It is and a business fact that cost of prevention is negligible against the cost of a cure. The time involved in seeking clarity later or resolving the dispute could be used more productively for doing business.

**Source:** *Adopted from a book on classification and exemptions authored by CA Madhukar N Hiregange, CA Vasant K Bhat and CA Nagendra Hegde.*

---

*(The content of the article is property of Hiregange& Associates, Chartered Accountants. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission, in writing, from the partners of the Firm)*