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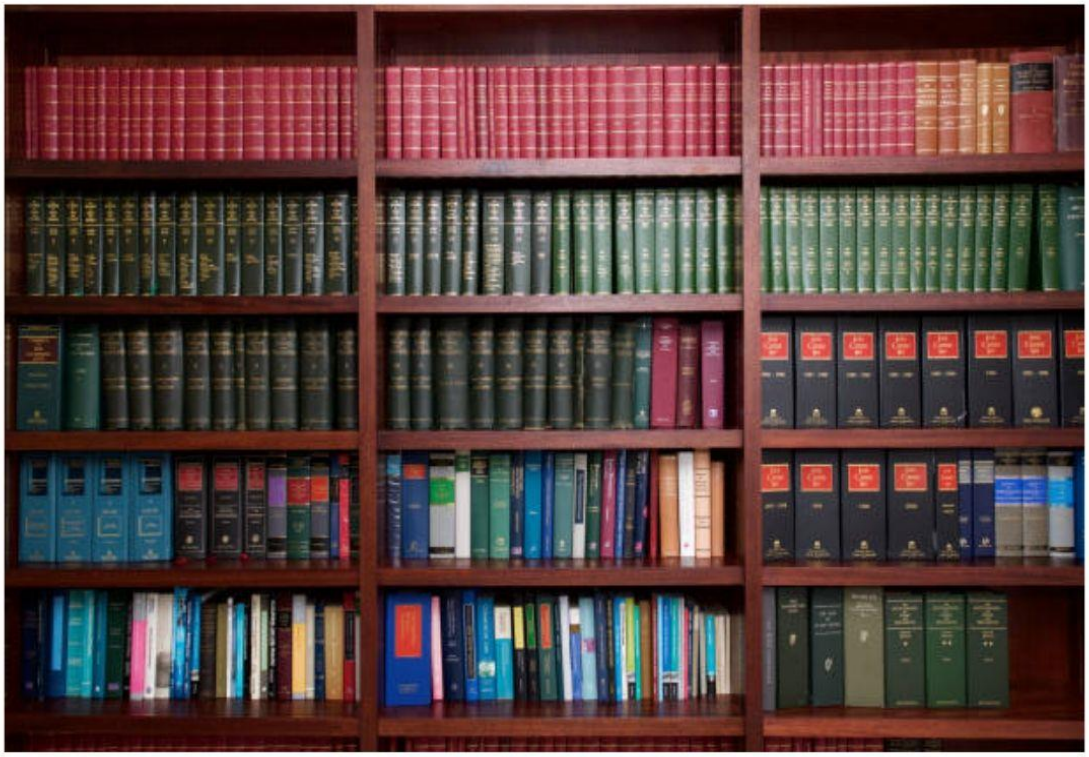


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## ARTICLE ON GST CLASSIFICATION OF BEAUTY PRODUCTS

# Beauty and Make-Up Preparations- Classification can turn Ugly

## INTRODUCTION

*"A rose by any other name smells just as sweet"*. Unfortunately, this doesn't apply in the sphere of indirect taxation, where the applicable rate of tax depends on its 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 a product or service falls. The primary intention of classifying them is to determine whether or not the same would be encumbered by the levy of taxes and if so, under which category the tax liability would arise. However, this is an ideal dream situation but in real and practical world disputes relating to classification of goods as well as services have been in existence since inception.

The ideal way to eradicate disputes relating to classification is to have rational tax rates and items that are plausibly classifiable under more than one heads should have the same rate of tax. Thus if for example, the rate of tax on all products is the same then probably there would never be a classification related dispute. Again this is only an ideal situation. In real life, classification has added more woes to certain industries as there is always a certain amount of arbitrage created between the taxpayer and the tax collector for the classification of items. The significance of classification assumes all the more importance when the variation in tax rates is huge and the tax spectrum is large. Under GST this spectrum ranges primarily from Nil to 28% (except for sin products). Incorrect classification of a product can have such serious implications that it can even lead to a closure of an industry. Say for example an industry having annual turnover of say 100 Cr. treats its products/services to be exempt and later it is found that the same is taxable @ 18% then at the time when SCN is issued to the company its liability would be 18% of 500 Cr. (100 Cr x 5 years) i.e. Tax of 90Cr. along with interest and penalty. It requires no rocket science to imagine that if a company having an average turnover of 100 Cr is saddled with such a huge liability it would be impossible for such a company to function. The significance of classification can very well be gauged from this simple illustration. It is equally important to have a clear and definitive classification of goods or services in which a person deals, at the earliest, to avoid a huge liability at a later stage.

Whenever the variation in rate is huge the tussle to classify items between the rates 18% or 28% shall be always on the cards. The Government in India being heavily dependent on the tax collections will always be tempted to classify items at the tax rate bracket of 28% and for the taxpayer, the situation will be vice-versa. The 10% gap between the rates, will always open the flood gates for litigation and divergent interpretations.

The classification of all kinds of 'Cosmetics and Ayurvedic products' which has some therapeutic or prophylactic uses and can plausibly also be classified as 'Medicaments' has always been a contentious issue in the taxation regime. The perplexity relating to the classification of 'Cosmetics and Ayurvedic products' has been a matter of concern for all the stakeholders in the industry. Various rulings in the erstwhile law and the current law, with different schools of thought, had made the concept much more complex rather than simplifying the issue.

This article is an attempt to throw some light and demystify the controversial issue relating to the classification of 'cosmetics and Ayurvedic products'.

The levy and collection of tax under GST is governed by Section 9 of the CGST Act, 2017 and corresponding provisions in the State GST Acts and IGST Act,2017. The relevant portion of the said Section reads as under:

> ***9. (1)*** *Subject to the provisions of sub-section (2), there shall be levied a tax called the central goods and services tax on all intra-State supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption, on the value determined under section 15 and* ***at such rates****, not exceeding twenty per cent.,* ***as may be notified by the Government*** *on the recommendations of the Council and collected in such manner as may be prescribed and shall be paid by the taxable person.*

## Classification of Goods as per Notification

That the Central Government in exercise of its powers under Section 9 of the CGST Act has issued **Notification No.1/2017-CT (Rate) dated 28th June, 2017**, which has been amended from time to time. The said notification has prescribed the rate of tax (Schedules) for specified goods under CGST/IGST ("Rate Notification"). This notification divides all the goods 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); and
vi. 0.125% (Schedule VI)

To determine the rate of tax on the products in question we need to examine the relevant competing entries concerning the product in question. The relevant entries are reproduced hereunder: -

**Schedule II- 6%**

| S.No | Chapter / Heading / Subheading /Tariff Item | Description of Goods |
|---|---|---|
| (1) | (2) | (3) |
| 62 | 3003 | Medicaments (excluding goods of heading 30.02, 30.05 or 30.06) consisting of two or more constituents which have been mixed together for therapeutic or prophylactic uses, not put up in measured doses or informs or packings for retail sale, including Ayurvedic, Unani, Siddha, homeopathic or Bio-chemic systems |

| | | |
|---|---|---|
| | | medicaments. |
| 63 | 3004 | Medicaments (excluding goods of heading 30.02, 30.05 or 30.06) consisting of mixed or unmixed products for therapeutic or prophylactic uses, put up in measured doses (including those in the form of transdermal administration systems) or in forms or packings for retail sale, including Ayurvedic, Unani, homeopathic siddha or Bio-chemic systems medicaments, put up for retail sale. |

**Schedule IV - 14%**

| S.No | Chapter / Heading / Subheading /Tariff Item | Description of Goods |
|---|---|---|
| **(1)** | **(2)** | **(3)** |
| 26 | 3304 | Beauty or make-up preparations and preparations for the care of the skin (other than medicaments), including sunscreen or sun tan preparations; manicure or pedicure preparations [other than kajal, kumkum, Bindi, Sindur, Alta].<br><br>*<u>***Omitted w.e.f. 15-11-2017***</u> |

**Schedule III - 9%**

| S.No | Chapter / Heading / Subheading /Tariff item | Description of Goods |
|---|---|---|
| **(1)** | **(2)** | **(3)** |
| 58 | 3304 | <u>***01-07-2017 to 14.11.2017***</u><br>Kajal pencil sticks.<br><br>*<u>***15-11-2017 onwards***</u><br><br>Beauty or make-up preparations and preparations for the care of the skin (other than medicaments), including sunscreen or sun tan preparations; manicure or pedicure preparations [other than kajal, Kumkum, Bindi, Sindur, Alta]. |

**Schedule III - 9%**

| S.No. | Chapter / Heading / Subheading /Tariff item | Description of Goods |
|---|---|---|
| (1) | (2) | (3) |
| 59 | 3305 9011, 3305 90 19<br><br>3305 | **01-07-2017 to 14.11.2017**<br>Hair oil<br><br>***15-11-2017 to 24-01-2018***<br><br>Preparations for use on the hair.<br><br>****25-01-2018 onwards***<br><br>Preparations for use on the hair. [except Mehendi pate in Cones] |

***Notification No.41/2017-Central Tax (Rate) dated 14th November, 2017 w.e.f.15th November,2017**

****Notification No. 6/2018-Central Tax (Rate) dated 25th January,2018.**

It is pertinent to note that the Explanation to the Rate Notification No. 1/2017-Central Tax (Rate) dated 28.06.2017 states as under:

***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.***

Therefore, while the Rate Notification under GST provides the rate of tax on goods and services, to interpret these Rate Notifications for purposes of levy of GST, one has to read the same along with the First Schedule (including the Section and Chapter Notes and General Explanatory Notes) of the Customs Tariff Act, 1975 ("Tariff").

Relevant Chapter Note of Customs Tariff Act, 1975 (51of 1975) read with Notification No. 1/2017-CT (Rate) dated 28th June, 2017 reads as under: -

**Chapter 30 Note 1(e)**

*'This Chapter (Ch. 30) does not cover preparations of heading 3303 to 3307, even if they have therapeutic or prophylactic properties.*

**The relevance of Section Notes, Chapter Notes, and HSN.**

One of the important tools relevant for the classification of any product has been provided for in the Harmonised System of Nomenclature (commonly abbreviated as HSN). This is an internationally accepted system of classification and the First Schedule to the Customs Tariff Act, 1975 is also based on this system of nomenclature. To some extent, GST also follows this system of classification and Notification No. 1/2017-CT (Rate) is also based on HSN classification to a certain extent.

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 apply to each Chapter which is part of a specific section of the Tariff.

Thus the principle to be followed for determining the rate of tax on a particular product is as follows:-

(i) Ascertain the Chapter / Heading / Sub-heading / Tariff item of the product in question and match it with the description of goods (given in Column no. 3) of Notification No.1.

(ii) The description which matches most with the respective HSN shall be the appropriate classification of the said goods.

(iii) In case of ambiguity refer to the ***rules for the interpretation of the First Schedule to the Customs Tariff Act, 1975***

Thus in case of ambiguity classification is to be determined only based on the description of the heading read with relevant section or Chapter notes. Since these notes are part of the 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. In ***Fenner (India) Ltd v CCE (1995) 97 ELT 8 (SC)***, it was observed that the 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 the functional test of commercial parlance for the purpose of classification.

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 the exemption notification.

Only in cases where a notification is clear and expresses a specific intent the scope of Section Note or Chapter Note as the case may be, is restricted and the language of the notification shall be given preference. It was held so in the case of ***New Holland Tractors vs CCE (2010) 253 ELT 249 (CESTAT)***.

To determine the correct classification and rate of tax of Cosmetic Products having therapeutic or prophylactic uses it is imperative to understand the legal meaning of the terms used in Notification No.1 of 2017 dated 28th June, 2017.

In order to cater the complexities involved in the classification of Cosmetic or Ayurvedic products having therapeutic or prophylactic uses under the new regime, it is pertinent to acquaint ourselves with the terminologies such as 'Medicaments', 'Therapeutic' and 'Prophylactic uses' to establish the actual intent of entries falling under the Chapter Heading 30 and 33 of Notification No. 1/2017-CT (Rate) dated 28th June 2017.

As the word, 'medicament' has not been defined anywhere in the Drugs and Cosmetics Act 1940, the Delhi Goods and Services Tax Act, 2017, the Central Goods and Services Tax Act, 2017, the Integrated Goods and Services Tax Act, 2017, the Customs Tariff Act, 1975, or rules framed thereunder, the word must be construed in its popular sense i.e. how the common man who uses it, understands it.

The term 'medicament' as defined in the ***Oxford Dictionary*** is 'a substance used for medical treatment'

As per ***McMillan Dictionary*** medicament is 'a substance used for treating an illness or injury'.

The ***American Heritage Medical Dictionary*** defines it as 'An agent that prompts recovery from injury or ailment; a medicine'.

The term therapeutic as defined in the ***Oxford Dictionary*** is a treatment designed to help/treat an illness

As per ***Collins Dictionary,*** therapeutic treatment is designed to treat an illness or to improve a person's health, rather than to prevent an illness and

Similarly, the ***dictionary meaning*** of Prophylactic Uses is a substance or device used for preventing disease.

In other words, to determine whether or not a product or a formulation is to be labelled as a 'medicament' it is necessary to consider its efficacy in treating or remedying an 'injury' an 'ailment' an 'illness' or a 'disease'.

Hence, it becomes imperative to look into the definition of 'injury'.

***Miller-Keane Encyclopaedia and Dictionary of Medicine, Nursing, and Allied Health, Seventh Edition*** defines 'injury' as 'harm or hurt; usually applied to damage inflicted on the body by an external force'.

Again, in Medical terms 'illness' or 'ailment' is often defined as 'a physical or mental disorder'

It is imperative to note here that the word 'medicament' is not defined anywhere while the word "cosmetic" is defined in the Drugs and Cosmetics Act, 1940.

The ***Drugs and Cosmetics Act, 1940***, defines cosmetic under ***clause (aaa) of section 3*** to mean any article intended to be rubbed, poured, sprinkled or sprayed on, or introduced into, or otherwise applied to, the human body or any part thereof for cleansing, beautifying, promoting attractiveness, or altering the appearance, and includes any article intended for use as a component of cosmetic.

## Medicament vs Cosmetic

On perusal of the definitions of the word Medicaments and Cosmetics, one school of thought may be that cosmetic products are meant to improve the appearance of a person, that is, they enhance beauty. Whereas a medicinal product or a medicament is meant to treat some medical condition. It may happen that while treating a particular medical problem, the appearance of the person concerned may improve. What is to be seen is the primary use of the product. To illustrate, a particular product may be used for treating baldness. Baldness is a medical problem. By use of the product, if a person can grow hair on his head, his ailment of baldness is cured and the person's appearance may improve. The product used for the purpose cannot be described as cosmetic simply because it has ultimately led to an improvement in the appearance of the person. The primary role of the product was to grow hair on his head and cure his baldness.

Also, the extent or the quantity of medicament used in a particular product will not be a relevant factor to determine whether a product qualifies to be a medicament or not. Normally, the extent of use of medicinal ingredients is very low because a larger use may be harmful to the human body. The medical ingredients are mixed with what is in the trade parlance called fillers or vehicles to make the medicament useful. To illustrate an example of Vicks Vaporub is given in which 98% is said to be paraffin wax, while the medicinal part i.e. Menthol is only 2%. Vicks Vaporub has been held to be medicament by this Court in ***CCE vs. Richardson Hindustan Ltd. 1989 (42) ELT A100***. Therefore, the fact that the use of a medicinal element in a product was minimal does not detract from it being classified as a medicament.

In order to be a medicinal preparation or a medicament, it is not necessary that the item must be sold under a doctor's prescription. Similarly, the availability of the products across the counter in shops is not relevant as it makes no difference either way.

## Classification Principles evolved by courts

**Trade / Common Parlance**

It is a cardinal principle of Tariff interpretation that resort must be had to the “popular sense” instead of the scientific and technical meaning. “Popular sense” connotes that which people conversant with the subject matter, with which the statute is dealing, would attribute to it.

Based on this principle, it was held in the case of ***Muller & Phipps (India) c. CCE (2004) 167 ELT 374 (SC)***, that “Prickly Heat powder” is ‘medicament’ as per common parlance, though, for 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 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)***

However, it is moreover important to know that the common parlance test is not a rigid formula capable of

being applied in all situations. That is why, in the case of ***Commissioner of CE vs. Ishan Research Lab***, the Supreme Court pointed out that the common parlance test is not "be all and end of the matter"

**Section/Chapter Notes prevail over Trade Parlance**

The classification under the Customs Tariff is not pendent 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 the correct and conclusive answer. Otherwise, one has to look at trade parlance.

The Supreme Court in case ***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 a 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 the classification of an item
- The aforesaid aids and assistance are more important than names used in the trade or common parlance in the matter of correct classification.

Now it can be seen that Chapter 30 prescribes the tariff for "Pharmaceutical Products". Heading No. 3003 speaks of medicaments consisting of two or more constituents which have been mixed together for therapeutic or prophylactic uses, not put up in measured doses or in forms or packings for retail sale, including Ayurvedic, Unani, Siddha, homeopathic or Bio-chemic systems medicaments.

Thus this Chapter 30 has to be read with the Chapter Note 1(e) which states that this Chapter (i.e. Ch. 30) **does not cover preparations of heading 3303 to 3307, even if they have therapeutic or prophylactic properties.**

Note 1(e) to Chapter 30 was considered by the ***Supreme Court in Puma Ayurvedic Herbal (P) Ltd. case***. It was observed that

> *"Thus preparations falling in Chapter 33 even if they have therapeutic or prophylactic properties will not fall under Chapter 30 which deals with pharmaceutical products. The reason for this appears to be that even cosmetics may have something to improve skin or other parts of the body where they are used. In that sense they may have some therapeutic value, yet they remain cosmetic."*

The distinction between primary and subsidiary therapeutic use was highlighted in the judgment of the Puma Ayurvedic case. It was stated that "a subsidiary curative or prophylactic use will not convert a cosmetic into

medicament". Then, it was clarified that the products which fall under Heading 3304 are primarily beauty or make up preparations. "They may incidentally help in protection against skin irritants. They may also help as a skin tonic, yet they are cosmetics because skin protection is subsidiary benefit". Thus, in considering the question whether the goods which fall broadly within the description of skincare products are to be classified as medicaments, the test that has to be applied is whether they are intended primarily for use in the treatment of skin disorders or diseases and whether the ingredients therein have sufficient but not minimal therapeutic value. If the potential of a product as a medicament to cure the skin ailments is not clear or is not established, then, it cannot be placed under Chapter 30 as 'medicament'.

Thus on reconciling the Chapter Heading with Chapter Note it indicates that only those products whose curative or preventive value is substantial and the product is manufactured primarily with a view to control or cure a skin-related disease by adding suitable pharmaceutical ingredients shall be covered under Chapter 30. That is to say, if preparations for the care of skin contain sufficient level of medicinal ingredient so as to offer a cure for skin ailments, they stand excluded from the purview of 3304. Broadly speaking, any skincare preparations shall more appropriately fall under the heading "medicaments" because of their therapeutic propensities only when they are used more specifically for the treatment of skin infections or other skin ailments. All other skin preparations and cosmetics even if they have therapeutic or prophylactic properties would not fall within the meaning of medicaments under the GST regime.

All earlier case-laws which dealt with similar issue might turn out to be redundant in light of the new scheme of classification provided in GST.

## Conclusion

With reference to the provisions of GST Laws, relevant notifications read with section and chapter notes of Customs Tariff Act 1975 and relying upon the erstwhile case laws along with the recent decision of Appellate of Advance Ruling in ***Akanksha Hair & Skin Care Herbal Unit (P.) Ltd., 2018] 96 taxmann.com 243 (AAAR-WEST BENGAL)*** it can be concluded that there is a very thin line of differentiation between the word 'Medicament' and 'Cosmetic' and one has to be very careful in demarking the classification of there products. Whereas the rate of tax of products covered under the head of Medicaments is 12%, the same product when seen with the eyes of cosmetics corresponds to 18% and even 28% in certain cases. What makes the difference is the perception with which one sees the product. Although the burden of proof that a product is classifiable under a particular Tariff head is on the Department but the company must understand this fact that the gap of 6%/16% may prove to be disastrous in case the litigation is decided in favour of the Revenue. Thus, classification of products should be done diligently keeping in view the afore-stated guiding principles and under professional guidance only.

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