DegreeLive

Bachelor of Business Administration (BBA) | Semester 4 | UK4VACMGT202

Goods and Service Tax – Theory and Practices

Course Code: UK4VACMGT202 • Module 2 Notes

degreelive.in

Chapter 1: The Taxable Event and Statutory Scope of Supply

1.1 Paradigm Shift: From Multiple Taxable Events to a Single 'Supply'

In indirect tax jurisprudence, the **Taxable Event** represents that definitive factual occurrence or legal nexus upon which the statutory charge of tax attaches and crystallizes legal liability. Prior to the enactment of the Goods and Services Tax, the Indian fiscal architecture was burdened by distinct and conflicting taxable events under separate statutes: Central Excise Duty attached to the "manufacture or production of goods" in India; State Value Added Tax (VAT) attached to the "transfer of property in goods for cash, deferred payment or valuable consideration" (the sale of goods); Service Tax attached to the "provision of taxable services"; and Entry Tax attached to the "entry of goods into a local area for consumption, use, or sale."

This multiplicity generated intractable judicial disputes concerning classification boundaries—most notably in hybrid commercial contracts such as software licensing, catering, works contracts, and intellectual property transfers. The Goods and Services Tax eradicated these fragmented taxable events, establishing a single, comprehensive statutory anchor: **The Supply of Goods or Services or Both**. Under Section 9 of the Central Goods and Services Tax Act 2017, the levy of tax is triggered exclusively upon the occurrence of a "supply."

1.2 Statutory Anatomy of Supply under Section 7

Section 7 of the CGST Act defines the statutory scope of supply through an inclusive and structured architecture:

Section 7(1)(a) – The General Commercial Supply: Encompasses all forms of supply of goods or services or both, such as sale, transfer, barter, exchange, license, rental, lease, or disposal made or agreed to be made for a **Consideration** by a person in the **Course or Furtherance of Business**. To constitute a taxable supply under this primary clause, four cumulative legal ingredients must coexist simultaneously: (1) There must be an underlying supply of goods or services; (2) The transaction must take the form of an enumerated commercial transfer (sale, barter, rental, lease, etc.); (3) It must be supported by quid pro quo consideration (monetary or non-monetary); and (4) It must be executed by a person in the course or furtherance of their business.

Section 7(1)(b) – Importation of Services: Covers the importation of services into India for a valuable consideration, whether or not such importation is in the course or furtherance of business. This provision ensures that even personal, non-commercial imports of high-value foreign services (e.g., an individual commissioning an architect in London to design a private residence in Kochi) remain subject to tax (remitted under reverse charge), preventing tax-free erosion of domestic service markets.

Section 7(1)(c) read with Schedule I – Supplies without Consideration: Forms a crucial statutory exception to the general doctrine that consideration is indispensable for taxation. Schedule I enumerates four specific commercial activities that are deemed to be taxable supplies even if executed wholly without consideration:

1. *Permanent Transfer or Disposal of Business Assets:* Where Input Tax Credit (ITC) has been previously availed on such business assets. If a corporation donates depreciated computers or office vehicles to a charitable trust, the transaction is deemed a taxable supply if ITC was claimed at the time of initial acquisition.

2. *Supplies between Related Persons or Distinct Persons:* Supply of goods or services between related entities (under Section 15 explanation) or distinct persons (branches of the same legal entity possessing separate GSTIN registrations located in different states or distinct verticals) when made in the course or furtherance of business. However, gifts not exceeding ₹50,000 in value in a financial year by an employer to an employee are exempt from being treated as supply.

3. *Supply of Goods between Principal and Agent:* Supply of goods by a principal to an agent who undertakes to supply such goods on behalf of the principal, or by an agent to a principal where the agent undertakes to receive such goods on behalf of the principal.

4. *Import of Services from Related Persons:* Importation of services by a taxable person from a related person or from any of their separate commercial establishments outside India, in the course or furtherance of business.

1.3 Schedule II: Classification of Activities as Supply of Goods or Services

To eliminate historical litigations regarding whether a hybrid transaction constituted goods or services, Section 7(1A) read with Schedule II establishes statutory classification rules:

Transactional Activity	Statutory Classification under Schedule II	Legal Rationale & Impact
Transfer of Title in Goods	Supply of Goods	Direct transfer of legal ownership and title in existing or future tangible goods.
Transfer of Right or Undivided Share in Goods	Supply of Services	Title remains with the owner; mere right to use or possess is transferred (e.g., operational leasing).
Lease, Tenancy, Easement, or License of Land/Building	Supply of Services	Commercial leasing or renting of immovable property for business or residential occupancy.
Treatment or Process Applied to Another's Goods	Supply of Services	Job-work operations, industrial dyeing, fabric processing, or contract manufacturing.
Transfer of Business Assets for Private Use	Supply of Services	Goods held for business are put to private personal use by directors or employees.
Renting of Immovable Property	Supply of Services	Renting of commercial premises, office buildings, or industrial plots.
Construction of a Complex, Building, or Civil Structure	Supply of Services	Under-construction property sales where consideration is received prior to completion certificate.
Temporary Transfer or Permitting Use of IPR	Supply of Services	Licensing of software, patents, trademarks, copyrights, or industrial trade secrets.
Agreeing to Refrain from an Act or Tolerate an Act	Supply of Services	Liquidated damages, non-compete agreements, contract cancellation charges, late penalty fees.
Works Contracts and Restaurant / Catering Services	Supply of Services	Composite contracts combining material supply and labor treated definitively as services.

1.4 Schedule III: The Negative List (Non-Supplies)

Section 7(2)(a) read with Schedule III enumerates activities or transactions which shall be treated neither as a supply of goods nor as a supply of services (the statutory Negative List):

1. Services rendered by an employee to the employer in the course of or in relation to their employment contract.

2. Services by any court or tribunal established under any law (including High Courts and the Supreme Court).

3. Functions performed by Members of Parliament (MPs), Members of Legislative Assemblies (MLAs), and constitutional post holders (President, Governors, Chief Election Commissioner, CAG).

4. Services of funeral, burial, crematorium, or mortuary including transportation of the deceased.

5. Sale of land and, subject to Schedule II, sale of building where the completion certificate has been issued or after first occupation.

6. Actionable claims, other than lottery, betting, and gambling (and specified online money gaming).

7. Out-and-out merchanting trade transactions: Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India.

8. Supply of warehoused goods to any person before clearance for home consumption (high sea sales).

Chapter 2: Bundled Supplies: Composite Supply versus Mixed Supply

2.1 The Concept of Bundled Supplies in Commercial Trade

In modern commerce, goods and services are rarely sold in complete isolation. Commercial enterprises routinely package multiple products, ancillary services, freight logistics, and extended warranties into consolidated offerings. Under pre-GST jurisprudence, tax authorities attempted to segregate every element and tax them under disparate statutes, generating immense litigation. Sections 2(30), 2(74), and 8 of the CGST Act introduce a structured statutory mechanism to classify and tax bundled transactions.

2.2 Composite Supply under Section 2(30) and Section 8(a)

Under Section 2(30), a **Composite Supply** means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are **Naturally Bundled** and supplied in conjunction with each other in the ordinary course of business, one of which is a **Principal Supply**. Under Section 2(90), the principal supply represents that element of the composite supply which constitutes the predominant element and to which any other supply forming part of the composite supply is ancillary.

Tax Liability Principle under Section 8(a): A composite supply comprising two or more supplies shall be treated as a supply of such principal supply. Consequently, the entire bundled transaction is taxed at the statutory GST rate applicable to the principal supply.

Commercial Examples:

1. *Air Conditioner Sale with Delivery and Installation:* An electronics merchant sells an air conditioner (taxable at 28%) and provides ancillary transport freight (5%) and installation services (18%). Because transport and installation are naturally bundled in the ordinary course of buying an air conditioner, the transaction is a composite supply. The air conditioner is the principal supply; hence, the entire bundled invoice is taxed at 28%.

2. *Passenger Airline Travel with In-Flight Meals:* An airline ticket (taxable at 5% for economy) includes complimentary baggage handling and an in-flight meal (normally 5% or 18%). The transport of the passenger is the predominant, principal supply. The whole bundle is taxed at 5%.

2.3 Mixed Supply under Section 2(74) and Section 8(b)

Under Section 2(74), a **Mixed Supply** means two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply. Crucially, a mixed supply involves elements that are **Deliberately Bundled** for commercial marketing or convenience, but can be supplied completely independently in the market.

Tax Liability Principle under Section 8(b): A mixed supply comprising two or more supplies shall be treated as a supply of that particular supply which attracts the **Highest Rate of Tax** among all the items included in the package.

Commercial Examples:

1. *Festive Gift Hamper:* A merchant offers a Deepavali gift package containing canned fruit juice (12%), dry fruits (12%), chocolate confectionery (18%), and aerated soft drinks (28% + compensation cess), sold together for a consolidated single price of ₹2,500. Each item can be bought and consumed independently; they are not naturally bundled. Therefore, the entire hamper is classified as a mixed supply and taxed at the peak rate of 28% plus cess, matching the highest-rated item.

2. *Hotel Accommodation with Free Sightseeing Tour:* A resort provides four nights of hotel accommodation alongside a separate water-sports adventure tour package for a single lump-sum charge. Because accommodation and water-sports are independent commercial offerings, the bundle is a mixed supply attracting the higher applicable tax rate.

Analytical Parameter	Composite Supply	Mixed Supply
Statutory Definition	Section 2(30) read with Section 8(a)	Section 2(74) read with Section 8(b)
Nature of Bundling	Naturally bundled in the ordinary course of business.	Artificially/deliberately bundled for marketing or promotional convenience.
Predominant Element	Clear, identifiable Principal Supply; other elements are purely ancillary.	No single principal supply; multiple independent supplies combined.

Analytical Parameter	Composite Supply	Mixed Supply
Pricing Mechanism	Can be billed as separate items or as a single price.	Must be supplied for a single, consolidated package price.
Tax Rate Determination	Taxed entirely at the rate applicable to the Principal Supply.	Taxed entirely at the highest rate among all items in the bundle.

Chapter 3: Determination of Place of Supply for Goods and Services

3.1 The Constitutional Primacy of the Place of Supply (POS)

Under India's destination-based GST model, determining whether a supply is an Intrastate transaction (attracting CGST + SGST) or an Interstate transaction (attracting IGST) depends on the statutory relationship between two spatial parameters:

1. **Location of the Supplier (LOS):** The registered place of business or fixed establishment of the supplier.

2. **Place of Supply (POS):** The statutory geographic destination where consumption is legally deemed to occur, as defined under the Integrated Goods and Services Tax (IGST) Act 2017.

If LOS and POS reside in the same State or Union Territory, the supply is **Intrastate**. If LOS and POS reside in different States, different Union Territories, or a State and Union Territory, the supply is **Interstate**. Determining POS is governed by Sections 10, 11, 12, and 13 of the IGST Act.

3.2 Place of Supply of Goods (Section 10 of the IGST Act)

Section 10 governs supplies of goods within India (excluding cross-border import and export):

Section 10(1)(a) – Supply Involving Movement of Goods: Where the supply involves movement of goods, whether by the supplier or recipient or any other person, the POS is the location of the goods at the time at which the movement of goods terminates for delivery to the recipient.

Section 10(1)(b) – Third-Party "Bill-to / Ship-to" Transactions: Where goods are delivered by the supplier to a recipient or any other person on the direction of a third person (whether by way of transfer of documents of title or otherwise), it is legally deemed that the third person has received the goods. The POS is the principal place of business of such third person. This legal fiction enables triangular commercial trading without unrecoverable tax leakage.

Section 10(1)(c) – Supply Not Involving Movement: Where supply does not involve movement of goods, the POS is the location of such goods at the time of delivery to the recipient (e.g., purchasing machinery currently installed on the factory floor of a leased warehouse).

Section 10(1)(d) – Assembly or Installation: Where goods are assembled or installed at site, the POS is the place of such installation or assembly (e.g., installing a central air-conditioning plant or electrical substation).

Section 10(1)(e) – Goods Supplied on Board a Conveyance: Where goods are supplied on board a conveyance (train, aircraft, passenger vessel), the POS is the location where the goods are taken on board the conveyance (e.g., food crates loaded onto a passenger train at Ernakulam Junction).

3.3 Place of Supply of Services (Sections 12 and 13 of the IGST Act)

Section 12 prescribes rules where both supplier and recipient are located within India. Section 13 applies where either the supplier or the recipient is located outside India.

General Default Rule under Section 12(2):

1. Supply made to a Registered Person (B2B): POS is the location of the recipient.

2. Supply made to an Unregistered Person (B2C): POS is the location of the recipient where address on record exists; otherwise, the location of the supplier.

Specific Statutory Exceptions under Section 12:

1. *Immovable Property Services (Section 12(3)):* Architect, real estate agent, interior decorator, hotel accommodation, or construction services. POS is the location where the immovable property is physically situated. If located outside India, POS is the location of the recipient.

2. *Restaurant, Catering, Personal Grooming, Fitness (Section 12(4)):* POS is the location where the services are physically performed.

3. *Training and Performance Appraisal (Section 12(5)):* If provided to a registered person (B2B), POS is the location of recipient; if provided to an unregistered person (B2C), POS is where the training is physically performed.

4. *Admission to Cultural, Artistic, Sporting, or Educational Events (Section 12(6)):* POS is the place where the event is actually held.

5. *Passenger Transportation Services (Section 12(9)):* For B2B, location of the registered recipient. For B2C, place where the passenger embarks on the conveyance for a continuous journey.

Chapter 4: Time of Supply, Valuation, and Reverse Charge Mechanism

4.1 Time of Supply (TOS) Architecture

The **Time of Supply** establishes the exact point in time when the tax liability crystallizes, determining the specific tax period (month or quarter) in which the supplier must remit the tax to the government treasury.

Time of Supply of Goods (Section 12): Under Section 12(2) read with Notification No. 66/2017-Central Tax, the time of supply for registered suppliers of goods (excluding composition dealers) is the earliest of: (1) The date of issue of invoice by the supplier; or (2) The last date on which the supplier is statutorily required under Section 31(1) to issue the invoice (i.e., before or at the time of removal of goods for delivery). Advance receipts on supply of goods are exempted from tax at the point of receipt; tax is payable only upon invoice issuance.

Time of Supply of Services (Section 13): Under Section 13(2), the time of supply of services is: (1) If invoice is issued within the statutory period of 30 days (45 days for banks/NBFCs) from the provision of service: Date of issue of invoice or date of receipt of payment, whichever is earlier; (2) If invoice is not issued within 30 days: Date of completion of service or date of receipt of payment, whichever is earlier. Advance payments received for services remain taxable immediately upon receipt.

4.2 Valuation of Supply under Section 15 and Statutory Deductions

Under Section 15(1), the value of a supply of goods or services shall be the **Transaction Value**—that is, the price actually paid or payable for the said supply, provided two mandatory conditions are met: (1) The supplier and recipient are not related persons; and (2) Price is the sole consideration for the supply.

Mandatory Inclusions under Section 15(2): Transaction value must statutorily include: (a) Any taxes, duties, cesses, and fees levied under any law other than GST (e.g., municipal taxes); (b) Any amount that the supplier is liable to pay in relation to the supply but which has been incurred by the recipient and not included in price; (c) Incidental expenses, including commission, packaging, transit insurance, and freight charged by the supplier; (d) Interest, late fees, or penalties for delayed payment of consideration; and (e) Subsidies directly linked to the price (excluding subsidies provided by the Central or State Governments).

Exclusions under Section 15(3) (Discounts): Trade discounts are deductible from transactional value if: (a) Given before or at the time of supply and duly recorded in the invoice; or (b) Post-supply discounts established under an agreement entered into before or at the time of supply, specifically linked to relevant invoices, and where the recipient has reversed the proportionate Input Tax Credit attributable to the discount.

4.3 The Reverse Charge Mechanism (RCM)

Under the standard Forward Charge mechanism, the supplier levies tax, collects it from the recipient, and remits it to the treasury. Under the **Reverse Charge Mechanism (RCM)** governed by Section 9(3) and Section 9(4), statutory liability to pay tax is inverted: the recipient of goods or services is legally obligated to remit the tax directly to the government treasury.

Key Notified Services under Section 9(3) Reverse Charge:

1. *Goods Transport Agency (GTA):* Supply of transport services by a GTA to specified registered entities (factories, registered societies, body corporates, registered partnerships), where the GTA does not exercise the option to pay under forward charge at 12%.

2. *Legal Services:* Services provided by an individual advocate or senior advocate or firm of advocates by way of legal consultancy or representational services to any business entity.

3. *Services by an Arbitral Tribunal:* Arbitral services provided to a commercial enterprise.

4. *Sponsorship Services:* Sponsorship provided by any person to any body corporate or partnership firm.

5. *Services by Directors:* Services provided by a director of a company or body corporate to the said company (excluding salary paid to executive directors subject to TDS under Section 192).

6. *Copyright Transfers:* Supply of services by an author, music composer, photographer, or artist by way of transfer or permitting the use of copyright relating to original literary, musical, or artistic works to a publisher or producer.

Statutory Compliance Rules for RCM: (1) The recipient paying tax under RCM cannot utilize existing electronic credit ledger balances; tax under RCM must be remitted strictly in **Liquid Cash** via the Electronic Cash Ledger; (2) The recipient is entitled to claim 100% Input Tax Credit on such tax paid, subject to general eligibility rules; and (3) The recipient must generate a self-invoice under Section 31(3)(f) at the time of receiving supplies from unregistered vendors.

Chapter 5: Valuation Rules, Pure Agent Provisions, and Practical Computations

5.1 Valuation Rules under Chapter IV of CGST Rules 2017

Where the transaction value cannot be determined under Section 15(1) because consideration is not wholly in money, or the parties are related, or transactions involve principals and agents, statutory valuation is governed by Rules 27 through 31:

Rule 27 – Consideration Not Wholly in Money: The value shall be: (a) The **Open Market Value (OMV)** of such supply; (b) If OMV is not available, the sum total of monetary consideration plus the monetary equivalent of non-monetary consideration if known at the time of supply; (c) If not determinable under (a) or (b), the value of supply of goods or services of **Like Kind and Quality**; or (d) If still not determinable, cost of production plus 10% under Rule 30, or the residual method under Rule 31.

Rule 28 – Supplies Between Related Persons or Distinct Persons: In commercial transfers between distinct persons (inter-branch stock transfers) or related entities: (a) Value is the Open Market Value; (b) If goods are intended for further supply as such by the recipient, the value may, at the option of the supplier, be an amount equal to 90% of the price charged to unrelated customers; and (c) Most importantly, the second proviso to Rule 28 establishes that where the recipient is eligible for **Full Input Tax Credit**, the value declared in the tax invoice shall be deemed to be the open market value of the goods or services, preventing endless valuation disputes for intra-firm corporate transfers.

Rule 30 – Cost-Based Valuation: Where value cannot be determined under preceding rules, the statutory value shall be **110% of the Cost of Production** or manufacture, or cost of acquisition of such goods, or the cost of provision of such services.

Rule 31 – Residual Best Judgment Method: Where value cannot be determined under Rules 27 to 30, the value shall be determined using reasonable means consistent with the general principles and statutory provisions of Section 15 and Chapter IV of the Rules.

5.2 The Statutory Concept of a Pure Agent (Rule 33)

In modern commercial operations, service providers routinely pay third-party statutory fees, municipal charges, or regulatory duties on behalf of their clients. Under Rule 33 of the CGST Rules, expenditure or costs incurred by a supplier as a **Pure Agent** of the recipient shall be excluded from the taxable value of supply, provided four cumulative statutory tests are fulfilled:

1. The supplier enters into a contractual agreement with the recipient of supply to act as their agent to incur costs or expenditure in the course of providing services.

2. The supplier neither intends to hold nor holds any title to the goods or services so procured or provided as a pure agent.

3. The supplier does not use for their own personal or corporate benefit the goods or services so procured.

4. The supplier receives only the actual amount incurred to procure such goods or services in addition to the amount received for their own service.

For example, when a practicing Company Secretary charges ₹15,000 as professional consulting fees and pays ₹5,000 as statutory incorporation filing fees to the Ministry of Corporate Affairs on behalf of the client company, the ₹5,000 statutory fee is excluded from the GST taxable base as pure agent disbursements, provided it is itemized separately in the commercial invoice.

5.3 Worked Numerical Resolutions in GST Valuation

To illustrate the practical application of Section 15 and the CGST Valuation Rules, consider the following comprehensive commercial scenarios with complete mathematical resolution:

Worked Example 1: Determination of Assessable Transaction Value under Section 15

A manufacturing enterprise in Ernakulam contracts to supply 500 industrial electric motors to an engineering firm in Kozhikode. The base agreed price is ₹12,000 per motor. The commercial contract stipulates the following additional financial terms:

1. Special vibration-proof transit packaging charged by the supplier: ₹45,000.

2. Pre-dispatch quality inspection fees paid by the buyer directly to an independent testing agency on behalf of the supplier (mandatory contract condition): ₹25,000.

3. Freight transport charges billed separately on the tax invoice by the supplier: ₹35,000.

4. Municipal octroi/cess paid by the supplier: ₹10,000.

5. Trade discount agreed at the time of supply of 5% on the base motor price, recorded on the invoice.

6. State Government renewable energy equipment capital subsidy received directly by the supplier: ₹50,000.

Step-by-Step Mathematical Resolution:

Base Transaction Value (500 motors × ₹12,000): ₹60,00,000.

Less: Statutory Trade Discount under Section 15(3)(a) (5% of ₹60,00,000): -₹3,00,000.

Subtotal after discount: ₹57,00,000.

Add: Special packaging charges under Section 15(2)(c): +₹45,000.

Add: Inspection charges paid by recipient on supplier's liability under Section 15(2)(b): +₹25,000.

Add: Outward freight charges under Section 15(2)(c): +₹35,000.

Add: Municipal cess under Section 15(2)(a): +₹10,000.

Treatment of Subsidy: Under Section 15(2)(e), subsidies provided by Central or State Governments are expressly excluded from transaction value; hence, ₹50,000 is not added.

Final Assessable Value under GST: ₹57,00,000 + ₹45,000 + ₹25,000 + ₹35,000 + ₹10,000 = **₹58,15,000**.

Applicable GST (Intrastate supply: 9% CGST + 9% SGST on ₹58,15,000): CGST = ₹5,23,350; SGST = ₹5,23,350. Total Invoice Value = ₹68,61,700.

Chapter 6: The Composition Levy Scheme under Section 10

6.1 Statutory Purpose and Theoretical Architecture

Small and Micro Enterprises (MSMEs) represent the operational backbone of India's commercial economy, yet they often lack the sophisticated accounting infrastructure, ERP systems, and professional tax staff necessary to navigate full GST compliance. To ease this compliance burden, Section 10 of the Central Goods and Services Tax Act 2017 establishes an optional, simplified tax framework known as the **Composition Levy Scheme**.

The composition scheme permits eligible small businesses to remit a low, flat percentage of their quarterly turnover directly to the government treasury in lieu of standard multi-tier GST rates, dispensing with detailed invoice-level tracking and complicated input tax credit calculations. It represents a statutory compromise: reduced compliance overheads and predictable fiscal liabilities in exchange for relinquishing the right to collect tax from buyers or claim input tax credit.

6.2 Eligibility Thresholds and Statutory Tax Rates

Under Section 10(1) read with Notification No. 14/2019-Central Tax, a registered taxable person whose **Aggregate Turnover** in the preceding financial year did not exceed **₹1.5 Crore** (₹75 Lakh in specified Special Category States: Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, and Uttarakhand) is eligible to opt for the composition scheme.

Category of Registered Person	Statutory Composition Tax Rate	Composition Turnover Base
Manufacturers of Eligible Goods	1% of Turnover (0.5% CGST + 0.5% SGST)	Turnover in State or Union Territory (taxable supplies).
Restaurant and Catering Service Providers	5% of Turnover (2.5% CGST + 2.5% SGST)	Turnover in State or Union Territory (excluding alcohol).
Traders of Eligible Goods	1% of Turnover (0.5% CGST + 0.5% SGST)	Turnover of *taxable* supplies of goods and services in the State.
Mixed Service Providers under Section 10(2A)	6% of Turnover (3.0% CGST + 3.0% SGST)	Applicable to small service providers with prior turnover up to ₹50 Lakh.

Marginal Service Provision by Goods Suppliers: Under the second proviso to Section 10(1), a registered person opting for composition who is primarily engaged in supplying goods or restaurant services is permitted to supply ancillary services up to a statutory ceiling of: **10% of turnover in the State in the preceding financial year, or ₹5 Lakh, whichever is higher**. This flexibility protects small shopkeepers who earn minor incidental service income (such as repair charges or interest on deposits) from losing their composition status.

6.3 Disqualifications and Ineligibility Conditions under Section 10(2)

Section 10(2) establishes strict disqualification criteria. A registered person is statutorily barred from opting for the composition levy if they:

1. Are engaged in the supply of goods or services which are not leviable to tax under the Act (e.g., alcoholic liquor for human consumption, petroleum products).

2. Make any **Interstate Outward Supply** of goods or services. (Crucially, composition dealers are permitted to procure interstate inward purchases, but are strictly prohibited from executing interstate outward sales).

3. Supply goods or services through an Electronic Commerce Operator (ECO) who is required to collect tax at source under Section 52 (subject to recent relaxed thresholds for unregistered small merchants).

4. Are a manufacturer of notified demerit commodities: Ice cream and other edible ice, Pan Masala, Tobacco and manufactured tobacco substitutes, Aerated waters, and Fly ash bricks/building bricks.

5. Are classified as a Casual Taxable Person (CTP) or a Non-Resident Taxable Person (NRTP).

6.4 Operational Compliance Mandates for Composition Taxpayers

Taxpayers operating under the composition levy must strictly comply with specialized statutory rules:

Prohibition on Tax Invoices and Tax Collection: Under Section 31(3)(c), a composition dealer cannot issue a standard GST Tax Invoice. Instead, they must issue a simplified **Bill of Supply**. Furthermore, they are legally barred from collecting any GST from the purchaser. The composition tax must be absorbed directly out of the merchant's business margins.

Total Bar on Input Tax Credit (ITC): A composition dealer cannot claim any Input Tax Credit on goods or services purchased for business operations. The GST paid to suppliers becomes a dead commercial cost added directly to inventory purchase costs.

Mandatory Signboard Disclosures: Under Rule 5 of the CGST Rules, a composition taxpayer must display the statutory words **"Composition Taxable Person, not eligible to collect tax on supplies"** prominently on every notice or signboard displayed at their principal place of business and every branch office, as well as on every Bill of Supply issued.

Simplified Return Architecture: Composition dealers do not file monthly returns (GSTR-1, GSTR-3B). Instead, they remit quarterly tax using a simplified challan-cum-statement in **Form GST CMP-08** by the 18th day of the month succeeding each quarter, and file a consolidated annual return in **Form GSTR-4** by April 30 following the close of the financial year.

6.5 Worked Numerical Scenario: Regular GST Scheme vs Composition Scheme

Consider a retail electrical hardware trader in Alappuzha with an annual domestic intrastate turnover of ₹80,00,000. All goods purchased carry an 18% GST rate. Total inward inventory purchases amount to ₹60,00,000 (plus 18% GST = ₹10,80,000). Commercial operating expenses (rent, utilities, wages) total ₹8,00,000. Let us simulate the financial outcomes under both tax schemes:

Scenario A: Regular Scheme

Outward Taxable Sales: ₹80,00,000.

Output GST Collected from Customers (18% on ₹80 Lakh): ₹14,40,000 (Invoice Total: ₹94,40,000).

Less: Eligible Input Tax Credit on Purchases: -₹10,80,000.

Net GST Payable in Cash to Government: ₹3,60,000.

Net Business Revenue: ₹80,00,000. Less Inward Purchases (₹60,00,000) and Operating Costs (₹8,00,000). Net Operating Profit = **₹12,00,000**.

Scenario B: Composition Scheme under Section 10

Outward Gross Sales (Price inclusive to customers): ₹80,00,000 (Customer pays exactly ₹80,00,000 via Bill of Supply).

Inward Purchases Cost (ITC is blocked, so tax is capitalized): ₹60,00,000 + ₹10,80,000 = ₹70,80,000.

Operating Expenses: ₹8,00,000.

Composition Tax Payable out of Turnover (1% on ₹80 Lakh): ₹80,000.

Net Operating Profit: ₹80,00,000 - ₹70,80,000 - ₹8,00,000 - ₹80,000 = **₹40,000**.

Commercial Takeaway: If a trader sells primarily to retail end consumers and is unable to pass on capitalized input taxes by increasing retail prices, the composition scheme can severely compress profit margins. However, if operating expenses are low and value addition is exceptionally high, composition provides unmatched simplicity.