K C Mehta & Co.
Chartered Accountants

kcmFlash
Goods & Service Tax
May 26, 2022

Apex Court helps Taxpayer sail through troubled waters, holds no IGST under RCM on Ocean Freight for CIF imports

Snapshot

The Supreme Court of India has upheld the ruling earlier given by Division Bench of Gujarat High Court[1] that IGST should not be leviable on ocean freight under Reverse Charge Mechanism ("RCM") for goods imported on CIF basis *(Cost, Insurance and Freight included incoterms)* by an Indian importer.

Division Bench of Gujarat High Court had earlier held the two notifications which imposed levy of IGST on transportation of goods in a vessel from a place outside India up to the customs station of clearance in India, as unconstitutional and as exceeding the powers conferred by the IGST Act and CGST Act.

Union of India had filed a Special Civil Application before the Supreme Court of India challenging the judgement given by the Division Bench of Gujarat High Court.

The Supreme Court has ruled as under –

- Levy of IGST on ocean freight under RCM for goods imported on CIF basis by Indian importer is violation of the principle of "composite supply". As the Indian importer is liable to pay IGST on the composite supply, comprising of supply of goods and services, for an import made on CIF basis, a separate levy on the Indian importer for the supply of services by the shipping line would be violation of section 8 of the CGST Act.
- The Government while exercising its rule-making power under the provisions of the CGST Act and IGST Act is bound by the recommendations of the GST Council. However, that does not mean that all the recommendations of the GST Council made by virtue of the power Article 279A (4) are binding on the legislature's power to enact primary legislations.

The Supreme Court also held that –

- The import of goods under a CIF contract constitutes an "inter-state" supply which can be subject to IGST – where the importer of such goods would be the recipient of shipping service.
- The IGST Act and the CGST Act define reverse charge and prescribe the entity that is to be taxed for these purposes. The specification of the recipient – in this case the importer – by Notification 10/2017 is only clarificatory. The Government by notification did not specify a taxable person different from the recipient prescribed in Section 5(3) of the IGST Act for the purposes of reverse charge.

[1] In case of Mohit Minerals Pvt Ltd Vs UOI

Background

- Notification No.8/2017- Integrated Tax (Rate) dated 28 June 2017 was issued by the Central Government on the advice of the GST Council, in exercise of powers under Section 5(1), Section 6(1) and Section 20(iii)-(iv) of the IGST Act, read with Section 15(5) and Section 16(1) of the CGST Act.

  Entry 9 of Notification 8/2017, effective from 1 July 2017, levied an integrated tax at the rate of 5 per cent on the supply of specified services, including transportation of goods, in a vessel from a place outside India up to the customs station of clearance in India.

- On 28 June 2017, the Central Government issued Notification 10/2017.

  Serial number 10 of Notification 10/2017 categorized the recipient of services of supply of goods by a person in a non-taxable territory by a vessel to include an importer under Section 2(26) of the Customs Act 1962.

- As value for the purpose of paying Customs Duty and IGST on import of goods made under incoterms CIF basis include the value of ocean freight, the notifications were challenged before the Gujarat High Court as the subject notifications create an element of double taxation.
- The Union of India urged before the Gujarat High Court that although tax is being paid twice on the value of ocean freight, it is not unconstitutional as the tax is on two different aspects of the transaction, namely, the supply of service and import of goods. The rationale for the impugned notifications, according to the Union Government, is to remove the disparity between Indian and foreign shipping lines.
- The Divisional Bench of the Gujarat High Court had held that the subject notifications are unconstitutional as it exceeds the power conferred by the IGST Act and the CGST Act and ruled –
  - The importer of goods on a CIF basis is not the recipient of transport service. The overseas supplier of goods (exporter) who arranges for transportation of goods is the service recipient.
  - Central government cannot specify a third person – who is neither the service provider nor the service recipient, as person liable to pay GST under RCM.
  - There is no territorial nexus for taxation since supply of service of transportation of goods is by a person in a non-taxable territory to another person in a non-taxable territory from a place outside India up to Indian customs clearance station and it is neither an inter-state nor an intra-state supply.
  - Since the importer pays customs duties on the goods which include the value of ocean freight, the subject notifications impose double taxation through a delegated legislation, which is impermissible.
- Union of India challenged the above ruling of Gujarat High Court before the Supreme Court vide SCA number 726 dated 23 Jan 2020.

Contentions of UOI as petitioner before the Supreme Court

- Even though the contracting parties viz. the overseas supplier (exporter) and foreign shipping line are outside the territory of India, the provision of service is for the Indian importer and hence consumption and

exhaustion of the service happens only in the hands of the Indian importer.

- CIF transaction and IGST on ocean freight are two independent transactions and can have independent levy. The subject transaction does not qualify as a "composite supply".
- The GST Council is the ultimate decision-making body in framing GST law. The power of the Parliament, State legislature and GST Council must be balanced and harmonized, such that neither overrides the other.
- The purpose is to make the Indian shipping lines as competitive as foreign shipping lines. ITC should be available to the Indian importer and the tax paid on RCM can be offset against output tax liability. Therefore, it is a mere alteration of the mechanism and there is no additional burden on the Indian importer.
- The expression 'by the recipient' in Section 5(3) of the IGST Act does not impede the authority of the GST Council in making recommendations for issuance of notifications for identifying such persons who shall be governed by reverse charge and once the identification is complete, such taxable person would automatically be interpreted as "the recipient".

Contentions of respondents before the Supreme Court

- The person liable to pay consideration to the foreign shipping line is the overseas supplier of goods (exporter) and therefore the respondent (as an Indian importer of goods) is not the recipient of service of ocean freight.
- Section 5(3) of the IGST Act provides that the Government may specify the 'categories of supply of goods or services or both' on which the tax shall be paid on RCM basis by the recipient of the goods or services whereas the impugned notification specifies the 'recipient' also.
- The objective of the tax or levy cannot validate an ultra vires levy as the service provider and the recipient both are in non-taxable territory.
- Levy of IGST on ocean freight for goods imported on CIF basis would amount to double taxation as cost of freight is included in the value of goods imported offered for the purpose of customs duty payments.

Ruling by the Supreme Court

- The recommendations of the GST Council are not binding on the Union and States. It only has a persuasive value. To regard recommendations of the GST Council as binding would disrupt the fiscal federalism, where both the Union and States are conferred equal power to legislate on GST.
- On a conjoint reading of Sections 2(11) and 13(9) of the IGST Act, read with Section 2(93) of the CGST Act, the import of goods by a CIF contract constitutes an "inter-state" supply which can be subject to IGST where the importer of such goods would be the recipient of shipping service.
- The IGST Act and the CGST Act define reverse charge and prescribe the entity that is to be taxed for these purposes. The specification of the recipient – in this case the importer – by Notification 10/2017 is only clarificatory. The Government by notification did not specify a taxable person different from the recipient prescribed in Section 5(3) of the IGST Act for the purposes of reverse charge. Hence, an importer receiving goods from a foreign shipping line can be a "recipient of service" under IGST and such an importer is amenable to tax under RCM.

- The impugned levy imposed on the 'service' aspect of the transaction is in violation of the principle of 'composite supply' enshrined under Section 2(30) read with Section 8 of the CGST Act. Since the Indian importer is liable to pay IGST on the 'composite supply', comprising of supply of goods and supply of services of transportation, insurance, etc. in a CIF contract, a separate levy on the Indian importer for the 'supply of services' by the shipping line would be in violation of Section 8 of the CGST Act.

Thus, while the Apex Court observed that importer can be notified as person liable to pay tax under RCM and that the subject service is an inter-state supply of service, it held that levying tax on ocean freight for goods imported on CIF basis would be in violation of the principle of composite supply and accordingly dismissed the appeal filed by the revenue.

In a nutshell, the levy of IGST on ocean freight for goods imported on CIF basis by Indian importer has been struck down by the Apex Court.

KCM Note

Pending the outcome of SCA filed by UOI before the Supreme Court, the GST officials were demanding IGST on ocean freight paid on CIF imports. All these inquiries, disputes and litigation should now cease with the ruling of Apex Court.

Importers who have already paid IGST on ocean freight can explore the option of claiming refund of IGST so paid. Refund should be allowed to the extent of which Input Tax Credit (ITC) has not been claimed by the importers.

For further analysis and discussion, you may please reach out to us.

Locations

Ahmedabad
Arpit Jain
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015

Phone: + 91 79 4910 2200
arpit.jain@kcmehta.com

Bengaluru
Payal Shah
19/4, Between 7th & 8th Cross,
Malleswaram,
Bengaluru - 560 003

Phone: +91 80 2356 1880
payal.shah@kcmehta.com

Mumbai
Vishal Doshi
508, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai - 400069

Phone: +91 22 2612 5834
vishal.doshi@kcmehta.com

Vadodara
Milin Mehta
Meghdhanush,
Race Course,
Vadodara - 390 007

Phone: +91 265 2440400
milin.mehta@kcmehta.com