INDIRECT TAX

Levy of IGST on ocean freight in CIF contracts violates the principle of composite supply under Section 8 of the IGST Act

UPDATE NO. 23 OF 2022

Lakshmikumaran & Sridharan attorneys

exceeding expectations
SINCE 1985

The bone of contention in the batch of matters preferred by the revenue before the Hon'ble Supreme Court against the judgment of the Hon'ble Gujarat High Court is whether an Indian importer can be subject to the levy of Integrated Goods and Services Tax ('IGST') on the component of ocean freight paid by the foreign seller to a foreign shipping line, on a reverse charge basis. The Hon'ble Supreme Court has held that the levy of IGST on ocean freight on the Indian importer is in violation of the principles of composite supply enshrined under Section 2(30) read with Section 8 of the Central Goods and Services Tax Act, 2017 ('CGST Act').

Before the Hon'ble Gujarat High Court, the assessee challenged the legality and validity of the Entry No. 9(ii) of Notification No. 08/2017 – Integrated Tax (Rate) dated 28.06.2017 read with Entry No. 10 of Notification No.10/2017 – Integrated Tax (Rate) dated 28.06.2017 ('impugned notifications'). The assessee also challenged the levy of Goods & Services Tax on ocean freight being illegal under the provisions of Section 5(3) of the Integrated Goods & Services Tax Act, 2017 ('IGST Act').

BREIF FACTS

- The assessee imports goods by ocean transport on a Cost-Insurance -Freight ('CIF') basis from a place outside India, up-to the customs station in India. The assessee pays customs duties on the import of goods, which includes the value of ocean freight.

- In the case of a CIF contract, the freight invoice is issued by the foreign shipping line to the foreign exporter, without the involvement of the importer. Ocean freight is paid by the importer only when goods are imported under a Free-on-Board ('FOB') contract.

- Notification No.8/2017- Integrated Tax (Rate) dated 28 June 2017 was issued by the Central Government on the advice of the Goods and Services Tax 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 percent 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 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.

- The assessee alleges that the impugned notifications create an element of double taxation, as ocean freight is included in the value of goods for the purpose of customs duty which the importer is liable to pay. The assessee did not dispute the liability of integrated tax on supply of service of transportation when it imports goods on an FOB basis.

ISSUES:

The Court considered the following issues in its judgment:

1. Whether the Indian importer can be considered to be the recipient of services for the purpose of Section 5(3) of the IGST Act?
2. Whether the impugned notifications suffer from the vice of excessive delegation and hence *ultra vires* the IGST Act?
3. Whether the levy under the IGST Act amounts to double taxation?
4. What is the status of the recommendations passed by the GST Council under provisions such as Section 5(3) of the IGST Act?
5. Whether the imported goods procured on CIF basis constitute an inter-state supply or is it an extra-territorial tax?

DECISION:

Issue No. 1 –

- Section 5(3) of the IGST Act does not confer the powers on the Central Government to create a deeming ficion vis-à-vis who constitutes the recipient. Section 5(3) merely enables the Central Government to identify certain categories of goods and services, where the supplier of the service is charged on a forward charge basis.

- However, Section 13(9) of the IGST Act read with Section 2(93)(c) of the CGST Act inherently creates a deeming fiction for the importer of goods to be the recipient of shipping service.

Issue No. 2 –

- Section 5(3) of the IGST Act provides the Government the power to specify categories of supply of goods or services or both on which tax shall be paid on a reverse charge basis by the recipient.
  The Government is to exercise this power on the recommendation of the GST Council. The Government in exercise of its power under Section 5(3) of the IGST Act issued the impugned Notification 10/2017 specifying the 'categories of the supply' which shall be subject to reverse charge.

- The notification, besides specifying the criteria, has also mentioned the corresponding recipient in those categories.

- Both the IGST and CGST Act clearly define reverse charge, recipient and taxable persons. Thus, the Hon'ble Supreme Court concluded that the essential legislative functions vis-à-vis reverse charge have not been delegated. Therefore, the stipulation of the recipient in each of the categories in the impugned notification is only clarificatory. The Government by the impugned notification did not specify a taxable entity different from that which is prescribed in Section 5(3) of the IGST Act for the purposes of reverse charge.

Issue No. 3 –

- In a CIF contract, the supply of goods is accompanied by the supply of services of transportation and insurance, the responsibility for which lies on the seller (the foreign exporter in this case). The supply of service of transportation by the foreign shipper forms a part of the bundle of supplies between the foreign exporter and the Indian importer, on which the IGST is payable under Section 5(1) of the IGST Act read with Section 20 of the IGST Act, Section 8 and Section 2(30) of the CGST Act.

- To levy the IGST on the supply of the service component of the transaction would contradict the principle enshrined in Section 8 and be in violation of the scheme of the GST legislation.

- Based on this reason, while the impugned notifications are validly issued under Sections 5(3) and 5(4) of the IGST Act, it would be in violation of Section 8 of the CGST Act and the overall scheme of the GST legislation.

- The Hon'ble bench upheld the impugned judgment of the Hon'ble Gujarat High Court to the extent that a tax on the supply of a service, which has already been included by the legislation as a tax on the composite supply of goods, cannot be allowed.

Issue No. 4 –

- The recommendation of the GST Council made under Article 279A is non-qualified. That is, there is no explanation on the value of such a recommendation. Yet the notion that the recommendations of the GST Council transform into legislation in and of themselves under Article 246A is farfetched.

- If the GST Council was intended to be a decision-making authority whose recommendations transform to legislation, such a qualification would have been included in Articles 246A or 279A. Neither does Article 279A begin with a non-obstante clause nor does Article 246A provide that the legislative power is 'subject to' Article 279A.

- The provisions of the IGST Act and CGST Act which provide that the Union Government is to act on the recommendations of the GST Council must be interpreted with reference to the purpose of the enactment, which is to create a uniform taxation system.

- The 'recommendations' of the GST Council are the product of a collaborative dialogue involving the Union and States. They are recommendatory in nature.

Issue No. 5 –

- Section 13(9) of the IGST Act creates a deeming fiction of place of supply of transportation services to be in India when the destination of goods is in India. In this case, it is clear the supplier of service- the foreign shipping line – is located outside India and the place of supply is India.

- Section 2(31) of the CGST Act defines 'consideration' to include payment made or to be made, in money or any other form, for the inducement of supply of goods or services to be made by the recipient or by any other person.

- Thus, in the case of goods imported on a CIF basis, the fact that consideration is paid by the foreign exporter to the foreign shipping line would not stand in the way of it being considered as a "supply of service" under Section 7(4) of the IGST Act which is made for a consideration, thereby constituting "supply of service" in the course of inter-state trade or commerce that can be subject to IGST under Section 5(1) of the IGST Act.

L&S comments:

The judgment is noteworthy as it recognizes the status of the GST Council v is-à-vis the legislature's powers to enact primary legislation. It is important to note that the impugned notifications are held to be clarificatory and not ultra vires the IGST Act. The levy of IGST on ocean freight has been set aside on the ground that such levy violates the tenets of composite supply under GST.

[*Union of India & Anr.* v. *Mohit Minerals Pvt. Ltd.* Through Director– Judgment dated 19 May 2022 in Civil Appeal No. 1390 of 2022, Supreme Court]

LOCATIONS

NEW DELHI

5 Link Road, Jangpura Extension,
New Delhi 110 014
PHONE: 011-4129 9800

B-6/10, Safdarjung Enclave,
New Delhi 110 029
PHONE: 011-4129 9900
E-MAIL: Lsdel@lakshmisri.com

MUMBAI

2nd Floor, CNERGY IT Park,
Old Standard Mill,
Appa Saheb Marathe Marg,
Prabhadevi,
Mumbai 400 025
PHONE: 022-2439 2500
E-MAIL: Lsbom@lakshmisri.com

CHENNAI

2, Wallace Garden, 2nd Street,
Chennai 600 006
PHONE: 044-2833 4700
E-MAIL: Lsmds@lakshmisri.com

BENGALURU

World Trade Center,
No. 404-406, 4th Floor, South Wing,
Brigade Gateway Campus,
No. 26/1 Dr. Rajkumar Road,
Malleswaram West,
Bengaluru 560 055
PHONE: 080-4933 1800
E-MAIL: Lsblr@lakshmisri.com

HYDERABAD

'Hastigiri', 5-9-163, Chapel Road,
Opp. Methodist Church, Nampally,
Hyderabad 500 001
PHONE: 040-2323 4924
E-MAIL: Lshyd@lakshmisri.com

AHMEDABAD

B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad 380 009
PHONE: 079-4001 4500
E-MAIL: Lsahd@lakshmisri.com

PUNE

607-609, Nucleus,
1 Church Road, Camp
Pune 411 001
PHONE: 020-6680 1900
E-MAIL: Lspune@lakshmisri.com

KOLKATA

2nd Floor, Kanak Building,
41, Chowringhee Road,
Kolkata 700 071
PHONE: 033-4005 5570
E-MAIL: Lskolkata@lakshmisri.com

CHANDIGARH

SCO No. 59, 1st Floor,
Sector 26, Madhya Marg,
Chandigarh 160 026.
PHONE: 0172-492 1700
E-MAIL: Lschd@lakshmisri.com

GURUGRAM

OS2 & OS3, 5th Floor,
Corporate Office Tower,
AMBIENCE Island, Sector 25-A,
Gurugram 122 001
PHONE: 0124-477 1300
E-MAIL: Lsgurgaon@lakshmisri.com

PRAYAGRAJ (ALLAHABAD)

3/1A/3, (Opp. Auto Sales)
Colvin Road, Lohia Marg,
Prayagraj 211 001
PHONE: 0532-242 1037/242 0359
E-MAIL: Lsallahabad@lakshmisri.com

KOCHI

1st Floor, PDR Bhavan,
Palliyil Lane, Foreshore Road,
Ernakulam, Kochi 682016
PHONE: 0484-486 9018/486 7852
E-MAIL: Lskochi@lakshmisri.com

JAIPUR

2nd Floor (Front side),
Unique Destination, Tonk Road,
Near Laxmi Mandir Cinema Crossing,
Jaipur, Rajasthan 302 015
PHONE: 0141-456 1200
E-MAIL: Lsjaipur@lakshmisri.com

NAGPUR

1st Floor, HRM Design Space,
90-A, Next to Ram Mandir,
Ramnagar, Nagpur 440033
PHONE: +91-712-2959038/2959048
E-MAIL: Lsnagpur@lakshmisri.com

www.lakshmisri.com

Lakshmikumaran & Sridharan attorneys

exceeding expectations
SINCE 1985