# Levy of IGST under RCM on Ocean Freight held Unconstitutional by SC
# Analysis of Judgement and Way forward for Taxpayers

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With the passage of almost 5 years of GST, there have been many areas where there has been disputes between the Authorities and the taxpayers regarding the taxability of transactions. One such area is the imposition of tax on Ocean Freight services especially when import is on CIF basis. While on the CIF value, one gets to pay Customs duties as well as IGST on the value of the imports, there has been an artificial levy of IGST on the freight component treating the same as chargeable to GST under Reverse Charge Mechanism as well.

Now, the Hon'ble Supreme Court has laid to rest the anomaly in the space of levy of Reverse Charge Mechanism on the Ocean Freight element. The Hon'ble Supreme Court has upheld the judgement of the Gujarat High Court that 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.

**Union of India v. M/s Mohit Minerals Pvt. Ltd.** [2022-VIL-30-SC] - **Supreme Court of India**

The aforementioned case is discussed in brief below;

**Facts of the case:**

The respondents imported non-coking coal from Indonesia, South Africa and the U.S. by ocean transport on a 'Cost-Insurance-Freight' (CIF) basis which is supplied to domestic industries. The goods are transported from a place outside India, up-to the customs station in India. The respondent pays customs duties on the import of coal, 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. In the case of a high-seas sale transaction, the coal is purchased from the original buyer before it arrives at Indian ports.

Prior to the enforcement of the Goods and Services Tax ("GST") regime, service tax on ocean freight was exempted by Notification No. 25/2012-ST (Serial No. 34) dated 20 June 2012. This exemption was withdrawn by Notification No. 01/2017-ST dated 12 January 2017 which levied service tax on the importer, by a reverse charge mechanism.

With the advent of the GST regime, Notification No.8/2017-Integrated Tax (Rate) dated 28 June 2017 ("Notification 8/2017") was issued by the Central Government on the advice of the Goods and Services Tax Council ("GST Council"), in exercise of powers under Section 5(1), Section 6(1) and Section 20(iii)-(iv) of the Integrated Goods and Services Tax Act 2017 ("IGST Act"), read with Section 15(5) and Section 16(1) of the Central Goods and Services Act ("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 ("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 respondent filed a writ petition before the Gujarat High Court challenging Notification 8/2017 and Notification 10/2017 on the grounds that:

a) the notifications are ultra vires the IGST Act and CGST Act;

b) customs duty is levied on the component of ocean freight and the levy of IGST on the freight element in the course of transportation would amount to double taxation;

c) though in the case of high sea sales, the importer is a different entity, yet this regime would tax the respondent as the importer and the recipient of service;

d) in the case of a CIF contract, the supply of service of transport of goods in a vessel is by a foreign shipping line located in a non-taxable territory to an exporter located in a non-taxable territory by a vessel outside the territory of India which cannot be subject to tax under the IGST Act;

e) Notification 10/2017 transgresses the provisions of Section 5(3) of the IGST Act as instead of the "recipient" mentioned therein, the "importer" as defined in section 2(26) of the Customs Act, is made liable to pay tax; and

f) Entry 9(ii) and para 2 of Notification 8/2017, read with Notification 10/2017, creates a deeming fiction and a separate taxable event which is not permissible in law.

The Gujarat High Court held that:

i. The RCM Notification is ultra vires the IGST Act, 2017.

ii. The importer of goods on a CIF basis is not the recipient of the transport services as Section 2(93) of the CGST Act defines a recipient of services to mean someone who pays consideration for the service, which is the foreign exporter in this case;

iii. Section 5(3) of the IGST Act enables the Government to stipulate categories of supply, not specify a third-party as a recipient of such supply;

iv. There is no territorial nexus for taxation since the 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 the Indian customs clearance station and this is neither an inter-state nor an intra-state supply;

v. Section 2(11) of the IGST Act defines "import of service" to mean the supply of service where the supplier of service is located outside India, the recipient of service is located in India and the place of supply of service is in India;

vi. In this case, since the goods are transported on a CIF basis, the recipient of service is the foreign exporter who is outside India;

vii. Section 7(5)(c) of the IGST Act dealing with intra-state supply cannot be read so extensively that it conflates the "supply of goods or services or both in the taxable territory" to "place of supply";

viii. Sections 12 and 13 of the IGST Act deal with determining the place of supply. Neither of them will apply if both the supplier and recipient of service are based outside India. The mere fact that the service terminates at India does not make the service of supply of transportation to be taking place in India;

ix. The provisions regarding time of supply, as contemplated in Section 20 of the IGST Act and applicable to Section 13 of the IGST Act dealing with supply of services, are applicable only vis-à-vis the actual recipient of the supply of service, which is the foreign exporter in this case;

x. Section 15(1) of the CGST Act enables the determination of the value of the supply, only between the actual supplier and actual recipient of the service

xi. Since the importer is not the "recipient" of the service under Section 2(93) of the CGST Act, it will not be in a position to avail ITC under Section 16(1) of the CGST Act; and

xii. Since the importer pays customs duties on the goods which include the value of ocean freight, the impugned notifications impose double taxation through a delegated legislation, which is impermissible.

The matter was taken to the Hon'ble Supreme Court. The Hon'ble Court has now passed their order on the issue in two parts, the first one is relating to challenge to the Constitutional validity of levy of tax under reverse charge on ocean freight services and other one is relating to binding nature of recommendations of the GST Council.

**Held:**

The Hon'ble Court observed that they are bound by the confines of the IGST and CGST Act to determine if CIF Imports transactions may be considered as standalone transaction i.e one as supply of goods (under the ambit of composite supply) and the other as supply of services or as composite supply. It would not be permissible to ignore the text of Section 8 of the CGST Act and treat the two transactions as standalone agreements. 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.

Thus, it was held that 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.

With respect to the **binding nature of the recommendations of the GST Council** the Hon'ble Court held as follows:

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 made binding on the Government when it exercises its power to notify secondary legislation to give effect to the uniform taxation system.

Merely because a few of the recommendations of the GST Council are binding on the Government under the provisions of the CGST Act and IGST Act, it cannot be argued that all of the GST Council's recommendations are binding. As a matter of first principle, the provisions of the Constitution cannot be interpreted based on the provisions of a primary legislation. It is only the provisions of a primary legislation that can be interpreted with reference to the Constitution. The legislature amends the Constitution by exercising its constituent power and legislates by exercising its legislative power.

Even if the Parliament that has enacted laws making the recommendations of the GST Council binding on the Central Government for the purpose of notifying secondary legislations, it would not mean that all the recommendations of the Council made by virtue of its power under Article 279A have a binding force on the legislature.

## Way Forward for Taxpayers

Reference the above judgement, levy of IGST as RCM on account of Ocean Freight @ 10% of total CIF value in case of Imports under CIF basis is rendered ultra-vires. Thus, the treatment of Ocean freight will now be as follows;

| Freight payment by Indian | Shipping Company | Treatment in GST |
|---|---|---|

| Importer/ Foreign Exporter | | Before SC Judgement | After SC Judgement |
|---|---|---|---|
| Foreign Exporter | Indian | Shipping Line to Pay GST under Forward Charge.<br><br>It will be Export of Services. | Shipping Line to Pay GST under Forward Charge.<br><br>It will be Export of Services. |
| Indian Importer | Indian | Shipping Line to Pay GST under Forward Charge.<br><br>It will be Inter-state or Intra state supply as per Sec 12 of IGST Act. | Shipping Line to Pay GST under Forward Charge.<br><br>It will be Inter-state or Intra state supply as per Sec 12 of IGST Act . |
| Foreign Exporter | Foreign | RCM payable by Indian Importer vide NTN 8/2017--IGST(R ) dt 28-07-2017 and NTN 10/2017--IGST(R ) dt 28-07-2017<br><br>ITC can be claimed on the RCM paid u/s 16 of CGST Act. | No Tax will be levied on such transactions |
| Indian Importer | Foreign | RCM payable by Indian Importer under Import of Services.<br><br>ITC can be claimed on the RCM paid u/s 16 of CGST Act. | RCM payable by Indian Importer under Import of Services.<br><br>ITC can be claimed on the RCM paid u/s 16 of CGST Act. |

## Treatment of Transactions of Earlier Period

**SC Judgement to applicable retrospectively:** Since the SC Judgement pertains to constitutionality of levy of RCM on ocean freight, it will have retrospective application w.e.f. 01st July 2017. The various scenarios can be discussed as follows;

| Scenarios before SC Judgement | Actionable by taxpayer |
|---|---|
| **No tax paid under Reverse charge** | Do nothing |
| **Tax paid under Reverse charge and claimed full input tax credit** | Do nothing |
| **Tax paid under Reverse charge but partial/ no input tax credit availed** | Apply for refund for GST on which no input tax credit is claimed |

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