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Levy of Ocean Freight under GST: Not all is well, even if it ends well!

In a landmark move, the Supreme Court in the case of ***UOI v. Mohit Minerals Private Limited, 2022-VIL-30-SC***, upheld the judgment of the Gujarat High Court in the case of ***Mohit Minerals Private Limited v. UOI, 2020-VIL-36-GUJ***, striking down the levy of GST on Ocean Freight. The ruling, being first of its kind, comes as a huge sigh of relief for the taxpayers under GST regime in so far as levy of GST on Ocean Freight, paid in case of import of goods on CIF basis is concerned. However, the ruling has opened pandora's box for the jurists and taxpayers to ponder. This article delves into the correctness or otherwise of the reasonings adopted in this judgment.

The dispute

It is a regular trade practice that importer of goods enters into an agreement with foreign supplier having Inco-terms where the in-transit insurance and transportation of goods by sea is also undertaken by the foreign supplier i.e., on Cost-Insurance-Freight ('CIF') basis. The goods are transported from a place outside India upto the Customs Station in India. The importer pays Customs Duty on CIF value and other applicable charges. The foreign supplier directly engages a foreign shipping line for transportation of goods by sea. The importer is not privy to this contract between foreign supplier and foreign shipping line and is not aware of the Ocean Freight charged by the foreign shipping line from the foreign supplier.

With the advent of GST, the Central Government issued ***Notification No. 8/2017-IGST (Rate)*** dated ***June 28, 2017*** prescribing rate of GST of 5% for 'transportation of goods in a vessel from a place outside India upto the customs station of clearance in India'. Simultaneously, the Central Government issued ***Notification No. 10/2017-IGST(Rate)*** dated ***June 28, 2017*** (both Notifications collectively referred to as 'Notifications') deeming the importer of goods to be the recipient of transportation services in case of import of goods on CIF basis.

Given the above, the bone of contention was whether an Indian importer can be subjected to levy of IGST on Ocean Freight paid by the foreign supplier to a foreign shipping line under reverse charge mechanism. In other words, as the importer is not recipient of ocean freight service in CIF contract, the Notification deeming the importer as recipient of service is *ultra-vires* the provisions of the Integrated Goods and Services Tax Act, 2017 ('IGST Act') or not.

The Ruling

The Gujarat High Court struck down the relevant entry of the Notification deeming the importer as recipient of service for being *ultra vires* of the parent statute as Indian importer is not a recipient of service in case of CIF imports. Per contra, the Supreme Court upheld the *vires* of the Notifications but concurred with the findings that GST is not leviable on Ocean Freight service on following grounds:

- Recommendations of GST Council are not binding on the Centre or the State Legislatures as there is no repugnancy provision envisaged in Article 246A of the Constitution of India.

- *Vide* Notifications, the Legislature did not delegate essential elements of levy of tax *viz.* taxable event, valuation etc. Thus, Notifications deeming importer of goods as recipient of service are not *ultra vires*.

- As per Section 13(9) of the IGST Act, place of supply of service of transportation of goods by sea is destination of goods i.e., in the case of import of goods, it would be in India. Reading this with definition of 'recipient' under Section 2(93) of the Central Goods and Services Tax Act, 2017 ('CGST Act') importer receiving goods through foreign shipping line is recipient of service for levy of GST under reverse charge as per Section 5(3) of the IGST Act. Hence, importer of goods is liable to pay GST on value of Ocean Freight service under reverse charge.

- Source of power to notify importer as recipient traced to Section 5(4) of the IGST Act and incorrect mentioning of provision in Notification will not vitiate their exercise and application.

- Place of supply of ocean freight service is in India and since goods are transported till India, there is sufficient territorial nexus for levy of GST.

- Levy of GST on service aspect of composite supply transaction violates concept of composite supply under Section 8 of the CGST Act as Indian importer is also liable to pay IGST on import of goods which includes cost of transportation service as well.

The debate

While the ruling correctly concludes that GST is not leviable on Ocean Freight service in the hands of importer of goods, it has unearthed multiple issues for times to come. On aspect of prescription of importer as a recipient of Ocean Freight service, the judgment has held that any Notification can be called *ultra vires*, if the essential function of legislature is delegated to Central Government. In the present instance, the essential function of providing the four pillars of taxes *viz.* taxable event, person liable to pay tax, rate of tax and measure of tax was well exercised by the legislature and prescription of importer as recipient in the Notifications was held to be merely clarificatory. Having said that, the Court concluded that Indian importer is the recipient of Ocean Freight service on the premise that Section 13(9) of the IGST Act provides for place of supply of transportation of goods service is India, being destination of goods. Reading this with definition of 'recipient' under Section 2(93) of the CGST Act, the Court held that importer receiving goods through foreign shipping line is recipient of Ocean Freight service for levy of GST under reverse charge mechanism in terms of Section 5(3) of the IGST Act.

Pertinently, Section 5(3) of the IGST Act is inextricably linked to the charging provision and deserves strict interpretation. The definition of 'recipient' of service under Section 2(93) of the CGST Act only covers person liable to pay consideration for service or person to whom service is rendered. There is no third category of person covered in definition of 'recipient'. Therefore, importer of goods can never qualify as recipient of Ocean Freight service being neither liable to pay consideration to foreign shipping line for such service nor being a recipient of such service from foreign shipping line in the absence of any privity of contract. Furthermore, the ruling has held that source of power to notify importer as recipient is traceable to Section 5(4) of the IGST Act as Section 5(4) expands the scope of recipient. Section 5(4), also being essential part of levying provision, needs to be strictly interpreted and a plain reading of Section 5(4) clearly shows that it only encompasses 'recipient' and not any other person. In other words, Section 5(4) does not expand the scope of the term 'recipient'.

It is clear from the Notifications that they provide for the person liable to pay tax as also for the measure of tax (value at which tax would be payable). It is a trite law that such vital elements of taxation cannot be left to the realm of delegated legislation, but the same needs to be enacted by the legislature in the statute itself. Therefore, on this point, the judgment clearly is not in sync with the past jurisprudence.

The judgment took note of the fact that import of goods on CIF basis is essentially a composite nature of supply under Section 8 of the CGST Act on which IGST is payable at the time of import. This composite nature of supply cannot be vivisected to isolate the Ocean Freight service and tax it separately under reverse charge mechanism. Thus, the Notification seeks to double tax the Ocean Freight service and destroy the composite supply aspect of the CIF transaction.

In Author's considered view, the above reasoning that import of goods on CIF basis qualifies as composite supply is incorrect since it is a single supply of goods from foreign exporter to importer wherein ownership in goods gets transferred at Indian port. Further, two supplies in question (supply of goods by foreign exporter and supply of Ocean Freight service by foreign shipping line) are provided by separate persons to separate recipients which can never be in conjunction and therefore would not qualify as composite supply. Since the goods are supplied by foreign supplier to Indian importer on CIF basis, the service of transportation of goods provided by the foreign shipping line to the foreign supplier is an input service which the foreign supplier procures from the foreign shipping line to meets its obligations of supply of goods on CIF basis. For the Indian importer, there is only a single transaction of import of goods on CIF basis. Such a single transaction of import of goods on CIF

basis cannot be treated as a composite supply.

Another interesting conclusion that the ruling has given is that the recommendation of GST Council is not binding on the Centre or State legislatures. The interpretation is correct in the light of the 101st Constitutional Amendment Act. There is no specific provision in Article 246A to provide for resolving the repugnancy in case the laws framed by Union and States under GST are incongruent. This also finds support from the draft amendment Act which contemplated a dispute resolution mechanism which did not find its place in the 101st Constitutional Amendment Act. Having said that, thus far, both the Central and State Governments have consistently adhered to and implemented all recommendations of the GST Council in unison. It will be interesting to watch this space as to how with time, deviations occur between laws framed by Centre and States and how the recommendations of the GST Council are adopted/accepted. It is expected that the Centre and States soon come out with a mechanism to resolve their differences despite recommendations of GST Council.

Conclusion

After the ruling of the Gujarat High Court, the taxpayers were in a fix on the tax position that was required to be adopted. The Supreme Court judgment certainly brings clarity but has opened floodgates for more issues to come. As the ruling is favorable, taxpayers engaged in exempt supplies (where GST on Ocean Freight service becomes a cost) or having ITC accumulation and have paid GST in past, can contemplate claiming refund or seek adjustment subject to satisfaction of prescribed conditions. Moreover, basis this ruling, taxpayers can stop paying GST on future transactions. In the light of this ruling, it will be interesting to witness the fate of Service Tax on Ocean Freight which is under challenge and is still pending final decision from the Supreme Court. Though the Supreme Court has brought the much-desired respite to the taxpayers, they still need to pass through complex legal maze.

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