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EY Tax Alert

SC rules IGST is not leviable on inbound ocean freight in case of CIF contracts

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Executive summary

This Tax Alert summarizes a recent ruling[1] of the Supreme Court (SC). The issue involved was whether Integrated Goods and Services Tax (IGST) can be separately levied and collected from the Indian importer on ocean freight paid by the foreign exporter to a foreign shipping line, where Customs duty together with IGST has been already discharged on the value of imported goods.

SC concluded that:

- The recommendations of the GST Council are not binding on the Union and States.
- On a conjoint reading of Sections 2(11) and 13(9) of Integrated Goods and Services Tax Act, 2017 (IGST Act), read with Section 2(93) of Central Goods and Services Tax Act, 2017 (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.
- IGST Act and CGST Act define reverse charge and prescribe the entity that is to be taxed for these purposes. The specification of the recipient by the notification 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.
- Section 5(4) of the IGST Act enables the Central Government to specify a class of registered persons as the recipients, thereby conferring the power of creating a deeming fiction on the delegated legislation.
- Since the Indian importer is liable to pay IGST on the 'composite supply', comprising 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.

[1]TS-246-SC-2022-GST

Building a better working world

Background

- The taxpayer imported non-coking coal from Indonesia, South Africa and U.S.A. on Cost, Insurance and Freight (CIF) basis which is then supplied to domestic industries.
- It discharged custom duties on value of imported coal which is inclusive of freight amount.
- 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.
- Entry No. 9 of Notification No. 8/2017-IT(Rate), inter-alia, provides that IGST at the rate of 5% is leviable on service provided or agreed to be provided by way of transportation of goods by a vessel from a place outside India up to customs stations in India by a person to another, both located in a non-taxable territory.

  The value of such taxable service shall be deemed to be 10% of CIF value, if it is not available with the person liable to pay tax.
- As per Entry No. 10 of Notification No.10/2017-IT(Rate) (RCM notification), where supplier and recipient of above-mentioned service are in non-taxable territory, tax has to be paid by importer as defined under Customs Act.
- The taxpayer prayed before the division bench of Gujarat High Court (HC) for quashing the impugned notifications.
- HC observed that importer has neither availed transportation service nor he is liable to pay consideration. Thus, it cannot be required to pay tax on some supposed theory stating that he is directly or indirectly recipient of service.

  Hence, the division bench of HC held that the impugned notifications are ultra vires the IGST Act as they lack legislative competency.[2]
- Revenue preferred an appeal against the HC order before the Supreme Court (SC).

Revenue's contentions

- As contemplated in Article 286(2) read with Article 269A(1) of the Constitution of India, the Integrated Goods and Services Tax Act, 2017 (IGST Act) enacts provisions relating to the levy and collection of integrated tax, import and export of goods and services and location of supplier and recipient of services.
- In terms of Article 269A(5), IGST Act contemplates provisions for determining the nature of inter-State supply, place of supply of goods imported into or exported out of India and place of supply of services where the location of supplier and recipient is outside India.
- The charge created by Section 5(1) of IGST Act can extend to an ocean freight transaction to be taxed in the hands of the importer. This creation of a charge is in compliance with the essential components of taxation identified by the SC in case of Mathuram Agrawal and Gobind Saran Ganga Saran[3].

  The four fundamental principles of a taxing enactment are: the taxable event, the person on whom the levy is imposed, the rate at which the levy is imposed and the measure or the value to which the rate will be applied.

  Section 5(1) of IGST Act fulfills all the above principles.
- Section 5(3) of IGST Act and Section 9(3) of the Central Goods and Services Tax Act, 2017 (CGST Act) permit the Government, on the recommendation of the GST Council, to specify the categories of goods or services, the tax for which shall be paid on reverse charge basis by the recipient of such goods or services.
- Presently, neither the provisions nor the rules have identified the taxable persons for reverse charge. Hence, the impugned notifications are a legitimate exercise of delegated legislation. RCM notification identifies an importer as a recipient for the purposes of reverse charge. The power to issue such notification can be traced back to Section 5(3) and 5(4) of IGST Act.
- Import of service in this case is an inter-state supply in terms of Section 7(4) read with Section 13(1) and 13(9) of IGST Act. Although the contracting parties are outside India, the critical limb of the transaction happens in the taxable territory, namely, India. Hence, the transaction can also fall under Section 7(5)(c) read with Section 13(1) and 13(9) of IGST Act.
- Import of goods on CIF basis and ocean freight are two independent transactions, entitled to suffer independent levies.
- Indian importer can be termed as the recipient of service because:
  - Section 2(93)(c) of CGST Act envisages a recipient of an intangible service as one who does not pay consideration. In CIF transactions, the Indian importer does not pay for ocean freight and yet receives the benefit of transportation.
  - Section 2 of the CGST Act is prefaced with *"In this Act, unless the context otherwise requires"* which warrants a broad interpretation of statutory definitions therein.
  - Section 5(3) of IGST Act clearly enables the identification of service recipients, and not just categories of goods or services.
- Alternatively, the impugned notifications would be saved by Section 5(4) of IGST Act which permits the Union Government, on the recommendations of the GST Council, to specify a class of registered persons who shall in respect of specified categories of goods or services received from an unregistered supplier, pay the tax on reverse charge basis as the recipient.

  If this section is deemed applicable, then the importers would be liable for tax w.e.f. 1 February 2019, though exempted for the period from 13 October 2017 till 31 January 2019.
- Since the foreign shipping line and foreign exporter are

[2] TS-29-HC-2020(GUJ)-NT

[3] 1999 (8) SCC 667 and AIR 1985 SC 1041

located in a non-taxable territory, the Indian importer has to be taxed on a reverse charge basis since the service is consumed in India. The purpose is to make the Indian shipping lines as competitive as foreign shipping lines.

- Under Article 279A(4), decisions of the GST Council transform into recommendations to the Union and the States. The principal function of the GST Council is to take decisions, which are conveyed as recommendations. These recommendations have a unique constitutional status and they are overridden in exceptional circumstances.
- In terms of Section 15(4) and Section 15(5) of the CGST Act, Rules 27 to 31 of Central Goods and Service Tax Rules 2017 have been formulated. The Revenue can also assess the transaction by taking aid of a residual method prescribed under Rule 31. Any discretion vested in quasi-judicial authorities must be regulated.

Taxpayer's contentions

- Under Section 5(3) and 5(4) of IGST Act, the Government cannot specify the person liable to pay tax on a reverse charge basis.
- Clauses (a), (b) and (c) of Section 2(93) are mutually exclusive and cannot apply simultaneously. In case the supply of goods or services is for consideration, clause (a) applies, and the recipient is the person who is liable to pay the consideration.
- CGST Act does not envisage a taxable supply without consideration, other than those specified in Schedule I.
- The unamended section 5(4) was a standalone section, operating on its own, and did not require anything to be specified by way of a notification. Thus, RCM notification cannot be sustained under Section 5(4).
- The reliance placed by the Government on the amended Section 5(4) to justify RCM notification is erroneous as:
  - There was no power to issue a notification specifying the class of registered person liable to pay tax under reverse charge basis under Section 5(4) at the time when the impugned notification was issued on 28 June 2017. The power has been granted by amendment w.e.f. 1 February 2019.
  - Even after the amendment of Section 5(4), only the recipient can be specified as a person liable to pay tax.
- If the GST Council intended to make a recommendation deeming the importer as recipient of supply, then the proper course of implementation would be to make an amendment in the IGST Act and seek Parliamentary approval.
- Further, the objective of the tax or levy cannot validate an *ultra vires* levy.
- Section 13(5) of CGST Act is only relevant for determining the time of supply in case of clandestine supply or evasion of tax and cannot be used to determine time of supply for ocean freight services.
- The contract for transportation of goods is entered into by the foreign exporter with the foreign shipper. Thus, the person liable to pay consideration to the foreign shipper is the foreign exporter. The importer of goods in India is not the person liable to pay the consideration, and is thus, not the 'recipient' of the service.
- Sections 5(3) and 5(4) of IGST Act are merely machinery provisions for collection of tax, and not the charging provision.
- Section 5(1) is the charging section which levies IGST. Since there is no separate levy under Section 5(1) on ocean freight, the question of reverse charge does not arise.
- IGST Act has no extra-territorial application as the Act extends to the whole of India. Under Section 2(109) of CGST Act, taxable territory means the territory to which the Act applies. Further, in case of GVK Industries[4] Court observed that Parliament may exercise its powers with respect to an extra-territorial aspect when it has a nexus with India. It does not however empower delegated legislation to exercise such power. Thus, the activity brought within the tax net by the impugned notifications is contrary to the IGST Act.
- Rule 10 of the Customs Valuation (Determination of Value of Imported Goods) Rules 2007 includes cost of transportation and insurance in the value of goods, which forms the basis of the levy of IGST under the proviso to Section 5 of IGST Act. The impugned levy of IGST on ocean freight would amount to double taxation on the same transaction.
- GST Council which has been created by Article 279A of the Constitution is a recommendatory body, whose recommendations can be implemented by either amending the CGST Act or the IGST Act or by issuing a notification. However, notifications issued cannot be *ultra vires* the parent legislation.

SC ruling

Constitutional Architecture of GST

- GST Council has plenary powers under Article 279A (4)(h) where it could make recommendations on 'any other matter' related to GST.
- The Council has to arrive at its recommendations through harmonized deliberation between the federal units as provided in clause 6 of Article 279A. Unlike the other provisions of the Constitution which provide that recommendations shall be made to the President or the Governor, Article 279A states that the recommendations shall be made to the 'Union and the States'. The recommendation of the GST Council made under Article 279A is non-qualified i.e., there is no explanation on the value of such a recommendation.
- If the Council was intended to be a decision-making authority whose recommendations transform to

[4] 2011 (4) SCC 36

legislation, such a qualification would have been included in Articles 246A or 279A.

- The use of the phrase 'recommendations to the Union or States' indicates that the GST Council is a recommendatory body aiding the Government in enacting legislation on GST.
- In Manohar v. State of Maharashtra[5], a two-judge Bench of SC, while interpreting Section 20(2) of the Right to Information Act 2005, observed that the phrase 'recommendation' must be interpreted in contradistinction to 'direction' or 'mandate'.

Statutory Provisions and Scheme of the IGST Act

- The payment of IGST on reverse charge basis is envisaged on specific categories of supply of goods or services as notified by the Central Government. The tax in such scenario is payable by the recipient of such goods or services.

Do the impugned notifications suffer from excessive delegation?

- Both the IGST and CGST Act clearly define reverse charge, recipient and taxable persons.
- Thus, the essential legislative functions vis-à-vis reverse charge have not been delegated.
- The Government by 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.

Charging Section

Taxable person

- Neither Section 2(107) nor Section 24 of CGST Act qualify the imposition of reverse charge on a "recipient of service" and broadly impose it on "the persons who are required to pay tax under reverse charge". Since the RCM notification identifies the importer as the recipient liable to pay tax on a reverse charge basis under Section 5(3) of the IGST Act, the argument of the failure to identify a specific person who is liable to pay tax does not stand. Thus, the impugned notifications cannot be invalidated for an alleged failure to identify a taxable person.

Determination of value

- Parliament has provided the basic framework and delegated legislation provides necessary supplements to create a workable mechanism. Rule 31 specifically provides for a residual power to determine valuation in specific cases, using reasonable means that are consistent with the principles of Section 15 of the CGST Act. Thus, the impugned notification no. 8/2017 cannot be struck down for excessive delegation when it prescribes 10 percent of the CIF value as the mechanism for imposing tax on reverse charge basis.

Do imported goods procured on CIF basis constitute an inter-state supply or is it an extra-territorial tax?

- Taxpayer has argued that since the recipient of shipping services would be the foreign exporter and the place of supply would be the place of business of such foreign exporter, the transaction cannot be treated as import of service.
- However, in interpreting the expressions "recipient" and "place of supply", the Court would have to analyse these terms vis-à-vis the IGST Act and CGST Act and not exclusively from the provisions of the contract between the foreign exporter and foreign shipping line.
- Section 13(9) of 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.
- Section 2(31) of 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 CIF basis, the fact that consideration is paid by the foreign exporter would not stand in the way of it being considered as a "supply of service" under Section 7(4) of 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.
- The decision in GVK Industries (supra) clearly recognizes the power of Parliament to legislate over events occurring extra-territorially. The only requirement imposed by the Court is that such an event must have a real connection to India.
- The impugned levy has a two-fold connection: first, the destination of goods is India and thus, a clear territorial nexus is established with the event occurring outside the territory; and second, the services are rendered for the benefit of the Indian importer. Thus, the transaction does have a nexus with the territory of India.
- The statute itself is broad enough to cover a taxable event that has extra-territorial aspects, which bears a nexus to India.

Whether importers are service recipients under CIF contracts?

- The tax is payable "by the recipient" is in contradistinction to broad language such as "any person as may be prescribed" which was otherwise used in Section 98(2) of the Finance Act 1994.
- The power of the Central Government to designate persons and categories of supply for reverse charge derives from Sections 5(3) and 5(4) of the IGST Act and not Section 24(iii) of the CGST Act which mandates the compulsorily registration as a logical corollary to ensure tax collection.
- Section 2(98) of CGST Act, which defines "reverse charge" reiterates that it means the "liability to pay tax by the recipient of supply of goods or services or both instead of the supplier…". It cannot be construed to imply that any taxable person identified for payment of reverse charge would automatically become the recipient of such goods or service.
- The deeming fiction of treating the importer as a

[5] (2012) 13 SCC 14

recipient must be found in the IGST Act. As it currently stands, Section 5(3) of the IGST Act enables the delegated legislation to create a deeming fiction on categories of supply of goods/services alone.

- If Parliament's intention were to designate certain persons for reverse charge, irrespective of them being the recipient of such goods and services, it must make a suitable amendment to confer such power for exercise of delegated legislation.
- The only argument that supports the case of the Revenue is that of Section 13(9) of IGST Act read together with Section 2(93)(c) of CGST Act which defines a "recipient".
- In such a scenario, when the place of supply of services is deemed to be the destination of goods under Section 13(9) of the IGST Act, the supply of services would necessarily be "made" to the Indian importer, who would then be considered as a "recipient" under the definition of Section 2(93)(c) of CGST Act.
- This conclusion comports with the philosophy of the GST to be a consumption and destinated based tax. The services of shipping are imported into India for the purpose of consumption that is routed through the import of goods.
- Although the consideration for shipping is payable by the foreign supplier to the foreign shipping line in, the price is consequently factored into the price of the shipment. The ultimate benefactor of the shipping service is also the importer in India who will finally receive the goods in India. Thus, the meaning of the term "recipient" in the IGST Act will have to be understood within the context laid down in the taxing statute (IGST and CGST Act) and not by a strict application of commercial principles.

Applicability of section 5(4) of IGST Act

- Section 5(4) employs the language "as the recipient", in contradistinction to Section 5(3) of the IGST Act which uses "by the recipient".
- The provision clarifies that it may designate a class of registered persons as the recipient, thereby broadening the scope of Section 2(93) of the CGST Act, which is anyway an inclusive definition since Section 2 is prefaced with "unless the context otherwise requires".
- As long as a source of power to legislate or issue a notification is available, the lack of a mention, an incorrect reference or mistake does not vitiate the exercise of such power.

Composite supply and Double taxation

- On the first leg of the transaction, between the foreign exporter and the Indian importer, the latter is liable to pay IGST on the transaction value of goods under Section 5(1) of the IGST Act read with Section 3(7) and 3(8) of the Customs Tariff Act. Although this transaction involves the provision of services such as insurance and freight, it falls under the ambit of 'composite supply'.
- Section 20 of the IGST Act provides that the provisions relating to 'composite supply' under CGST Act would apply *mutatis mutandis* under IGST Act. By extension, the IGST in a transaction of composite supply would be levied on the principal supply of goods.
- The idea of introducing 'composite supply' was to ensure that various elements of a transaction are not dissected, and the levy is imposed on the bundle of supplies altogether.
- The Union of India cannot be heard to urge arguments of convenience – treating the two legs of the transaction as connected when it seeks to identify the Indian importer as a recipient of services while on the other hand, treating the two legs of the transaction as independent when it seeks to tide over the statutory provisions governing composite supply.
- The Court is bound by the confines of the IGST and CGST Act to determine if this is a composite supply.
- 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.

Conclusion

- The recommendations of the GST Council are not binding on the Union and States.
- On a conjoint reading of Sections 2(11) and 13(9) of IGST Act, read with Section 2(93) of 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.
- IGST Act and CGST Act define reverse charge and prescribe the entity that is to be taxed for these purposes. The specification of the recipient by RCM notification 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.
- Section 5(4) of the IGST Act enables the Central Government to specify a class of registered persons as the recipients, thereby conferring the power of creating a deeming fiction on the delegated legislation.
- 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.

Accordingly, the Revenue appeals are dismissed.

Comments

a. The ruling puts an end to a long-drawn litigation on taxability of ocean freight on the importer in case of CIF imports.

b. The judgement provides significant relief to the industry, particularly in cases where taxpayers are not able to claim full credit. On the flip side, the department may dispute the eligibility per se of input tax credit of IGST paid under reverse charge, in light of the judgement. One will need to evaluate the relevant provisions and judicial precedence in this regard.

c. For the past period, the importers, who are outside the GST credit chain, may consider claiming refund of tax paid under RCM. While doing so, it would be relevant to analyze the applicability of two years limitation period, since it can be argued that the levy of tax *per se* was not proper.

d. Considering the emphasis placed on the principle of composite supply, the impact of the SC ruling may also need to be seen in case of import of goods under FOB contracts.

e. Apex court's observations with regard to binding nature of the recommendations of GST Council may generate debate on various actions taken by the Government by way of implementation of various decisions of the Council in the past.

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