Demystifying Supreme Court decision - No GST on Ocean freight under RCM in CIF contract:

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Introduction

In this week, the Hon'ble SC has pronounced very interesting decision which has widespread in the media. The Hon'ble SC decision, besides holding that Indian importer is not liable for GST under RCM in CIF imports, has also explained several important aspects of Federal Constitution, GST council roles & rules of interpretation etc. In this article, the authors attempted to demystify the 153 page Decision and the possible course of action.

Legal background

Ocean freight (Transportation) in import transactions is central point of the decision. Popularly there are 2 ways of arranging transportation (contractually) as depicted below along with GST applicability:

Note 1: In all aforesaid cases, the Indian importer would be paying applicable IGST at the time of import (including the value of aforesaid Transportation).

Note 2: The Notifications made the Indian importer to pay GST in 4th Scenario with a premise to provide level playing field to the Indian Shippers for the reason that if an Indian shipping company ships the goods to India, they would pay the taxes under the forward charge, and thus non taxing the ocean freight charged by the foreign companies would render the Indian shipping industry noncompetitive in CIF contracts.

The Notifications asking Indian importer to pay GST *albeit* not being a contractual party to the Shipping contract in 4th scenario was challenged before Hon'ble Gujarat HC on multiple counts. After thorough analysis of Constitution, GST provisions, history of Indirect tax on Ocean Freight, the Hon'ble Gujarat HC has held that such notifications as *ultra vires* the IGST Act, 2017 & unconstitutional *inter alia* on several grounds as briefed below:

- The importer of goods on a CIF basis is **not the recipient of the transport services** as Section 2(93) of the CGST Act, 2017 defines a recipient of services to mean someone who pays consideration for the service, which is the foreign exporter in this case.
- Section 5(3) of the IGST Act, 2017 enables the Government to stipulate **categories of supply**, not specify a third-party as a recipient of such supply.
- The supply of service of transportation of goods by a person in a non-taxable territory to another person in a non-taxable territory from a place outside India up to the customs station of clearance in India, is neither an inter-State supply nor an intra-State supply. Thus, no tax can be levied and collected
- The location of the recipient of the service, i.e. the foreign exporter, is not in India but outside India. Thus, the provisions of sub-section (4) of Section 7 are also not applicable in the present case.
- 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".
- 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 in India does not make the service of supply of transportation to be taking place in India**;
- 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.
- 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.

- 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
- The provisions relating to the returns apply where the person is either a supplier or a recipient of the supply. If the person is neither a supplier nor a recipient of supply, such provisions do not apply
- The scheme of the GST is that it is a transaction/contract based on value added tax. The tax is levied on each transaction and the tax paid at early stage is available as credit. Hence, it is a tax on consumption and not on business. It is a contract-based levy which depends on the contract between the supplier and the recipient. Thus, where the tax is sought to be levied and collected by a person other than the supplier or the supplier of service, distortions and contingency which the Act does not covers, are bound to occur.
- 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.
- 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.

Similar decision was given in service tax context also by the same Hon'ble Guj HC[1]. Aggrieved by the decision of the Hon'ble Guj HC decision under GST, the Revenue department appealed it before the Hon'ble Apex Court. Painstaking arguments were made on both sides before Hon'ble SC on several aspects of Constitution (relating to GST council role & scope), GST provisions, Rules of interpretation etc.

Recently, the Hon'ble SC delivered decision on 19th May 2022 holding that Indian importer is not liable for GST on the Ocean freight in CIF import contracts under RCM. However, partly overturning the Hon'ble Guj HC, the Hon'ble SC held that Indian importer can be construed as 'Recipient of service' and the Notification is not *ultra vires* the IGST Act, 2017.

[1] SAL Steel Ltd. v. Union of India — 2020 (37) G.S.T.L. 3 (Guj.)

While arriving the decision, the Hon'ble SC elucidated various important principals regarding the Constitution, GST council role, GST law and interpretation rules. The highlights are tabulated below:

The legal arguments and the decision.....

	Taxpayer counsel	Government Counsel	Hon'ble SC verdict
a.	Section 5(3)[2] delegates the **power to identify the category** of goods or services (**and not class of recipient**) on which reverse charge applies. That, Nt. 10/2017 *ibid.* identifies an Indian **importer as a service recipient** for the purposes of Section 5(3), it is ***ultra vires* the parent Act on the ground of excessive delegation.**	• Recipient [2(93)(c)] any reference to a person to whom the supply is made – shall be construed as the reference to the "recipient". In terms of Section 13(9)[3] the supply is made to the importer. • Further, the term "taxable person" means – a person registered or liable to be registered. And Section 24(iii)[4], casts liability on the importer to get registered, as he is liable to pay tax under the reverse charge. • Therefore, 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 stipulation of the recipient in each of the categories in Notification is **only clarificatory.** 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.** • On a conjoint reading of Sections 2(11)[5] and 13(9), read with Section 2(93), 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.** • Section 24(iii) *ibid.* alone cannot deem an importer to be a "recipient", however, the argument in respect of Section 29(3)(c) read with 13(9) founds relevance as the place of supply of such services are in India, and the importer would be the recipient in terms of Section 2(93)(c) *ibid.*

[2] Of the IGST Act, 2017
[3] Of the IGST Act, 2017
[4] Of the CGST Act, 2017
[5] Of the IGST Act, 2017

b.	The importer cannot be validly termed as "taxable person".	From the revenue, the analogy drawn above w.r.t. "recipient", "taxable person" read with Section 24(iii) *ibid.* was put forward to identify the "importer" as the taxable person.	The impugned NT 10/2017 identifies the importer as the recipient liable to pay tax on a reverse charge basis under Section 5(3), **the argument of the failure to identify a specific person who is liable to pay tax does not stand.**
c.	The value has to be strictly determined by Section 15(1)[6] and not by way of delegated legislation.	Sections 15(4) and 15(5) read with Rule 31 - enable delegated legislation to prescribe methods for determination of value, on the recommendations of the GST Council.	Rule 31 specifically provides for a residual power to determine valuation. Thus, the impugned Nt. 8/2017 cannot be struck down for excessive delegation when it prescribes 10 per cent of the CIF value as the mechanism for imposing tax on RCM. The determination of the value of supply only through rules, and not by notification would be an unduly restrictive interpretation.
d.	The conditions specified under Section 2(11)[7] with regard to "import of services" does not satisfy – as the recipient and the place of supply are both outside India.	Section 13(9) of the IGST Act is applicable - where in case of supply of services of transportation of goods by a supplier located outside India, the place of supply would be the place of destination of such goods and thus the conditions of Section 2(11) Mets.	The supplier, the foreign shipping line, in this case would be a non-taxable person. However, its services in a CIF contract for transport of goods would enter Indian taxable territory as the destination of such goods. The place of supply of shipping service by a foreign shipping line, would thus be India.
e.	It was argued that the present case of CIF contract would not be covered within Section 7(1)(b)[8] as it does not define "supply" of import	The above analogy of Section 13(9) read with Section 2(11) was similarly placed.	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

[6] of the CGST Act
[7] Of the IGST Act
[8] of the CGST Act

	of service without consideration. Here, the consideration is paid by the foreign exporter.	Further, it was argued that Section 2(31)[9] defines "consideration" which includes amount paid by **"any other person"** within its purview.	service" under Section 7(4) of the IGST Act which is made for a consideration.
f.	The transaction takes place beyond the territory of India and is thus, extra territorial in nature. The levy of tax extra-territorially must be provided by Parliament through statute and not by the Union Government through delegated legislation.	That, the decision in **GVK Industries[10]** 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 on the supply of transportation service by the shipping line to the foreign exporter to import goods into India has a two-fold connection: **first**, the destination of the 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 game changer arguments

	Party	**Arguments**	**The Court observed**
a.	Revenue	Even if the above is not applicable, Section 5(4)[11] **[amended w.e.f. 1st Feb 2019]** would be applicable in the instant case. Which says – *"(4) The Government may, on the recommendations of the Council, by notification, **specify a class of registered persons** who shall, in respect of supply of specified categories of goods or services or both received **from an unregistered supplier,** pay the tax on reverse charge basis **as the recipient** of such supply of goods or services or both, and all the provisions of this Act shall apply*	This provision brings in a **deeming fiction of declaring a class of registered persons "as the recipient"** of the supply of taxable goods or service. In deploying the language **"as the", and not "by the" recipient**, the applicability of the definition of recipient vis-à-vis Section 2(93) of the CGST Act is no longer necessary for determining the validity of such a notification. The effect of the Amending Act 32 of 2018 has been as follows:

[9] of the CGST Act
[10] 2011 (4) SCC 36 ["GVK Industries"]
[11] Of the IGST Act.

		to such recipient as if he is the person liable for paying the tax in relation to such supply of goods or services or both." The issuance of notification under the incorrect reference i.e., 5(3) instead of 5(4), may not vitiate the action[12].	I. The powers of the Central Government to specify through a notification has been clarified; and II. The power to specify a class of registered persons as the recipient has been recognized.
b.	Assessee	That 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) 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.**	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. The Government at first pleaded to look beyond the agreement with the foreign exporter and treated the transportation and import transaction as one. Now, treating the two legs of the transaction as independent when it seeks to tide over the statutory provisions governing composite supply. For the reasons stated above, the appeals are accordingly dismissed.

The powers of the GST Council Clarified:

The Hon'ble Apex court held that

- The GST council recommendations are not binding on the Union and States and only have a persuasive value to foster cooperative federalism and harmony between the constituent units

[12] Union of India v. Tulsi Ram Patel (1985 3 SCC 398)

- The 'recommendations' of the GST Council are the product of a collaborative dialogue involving the Union and States. They are recommendatory in nature. To regard them as binding edicts would disrupt fiscal federalism, where both the Union and the States are conferred equal power to legislate on GST. It is not imperative that one of the federal units must always possess a higher share in the power for the federal units to make decisions. Indian federalism is a dialogue between cooperative and uncooperative federalism where the federal units are at liberty to use different means of persuasion ranging from collaboration to contestation
- 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 suggested course of action:

Hon'ble SC gives big sigh of relief to the Indian importers. It would be interesting to see how the Government will react. The suggested course of action is tabulated below:

S. No	Status	The suggested course of action
1	Not paid GST under RCM on Ocean freight	Not liable to paid & pending demands, if any can be contested
2	GST Paid under RCM, availed it as ITC & utilized	No action required
3	GST Paid under RCM, availed it as ITC but could not be utilized	Reverse unutilized ITC & can claim refund
4	Future period	➢ Continue to remit if taxpayer can utilize the ITC. This is to shield against the possible amendments to nullify the decision. ➢ If could not be utilized, can stop paying it or also pay under protest

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