

GST on ocean freight a controversy

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Introduction:

The shipping industry is a vital part of global freight transportation which caters global trade supply-chain. More than 90% of the world trade is through oceans as it is the most affordable and efficient mode of transporting goods, where large volume of goods can be carried on vessels for long distances at a fraction of a cost when compared to other modes of transport like rail, roads, air, etc. Before, going to analyze the applicability of GST on inward ocean freight and its valuation, let us understand the following terms.

Important terms:

- **Load port** means the port where the goods are loaded on a seagoing vessel by the exporter.
- **Port of discharge (Dispatch port)** is a place where a vessel is off-loaded and the shipments are dispersed to their respective consignees.
- **FOB (Free on Board):** The foreign exporters' (hereinafter also referred to as the 'Supplier') responsibility ends at the load port and Indian importer would be responsible for transportation of goods therefrom till their factory.
- **CIF (Cost, Insurance and freight)** the Supplier is responsible for transportation of the goods sold, till the port of destination.
- **Demurrage charges:** Demurrage charges are the compensation charges payable to the vessel owner (who is the supplier of the transportation services) for failure to load or unload the goods from the vessel within the time allowed.
- **Dispatch Bonus:** Dispatch money/bonus refers to an amount paid by the vessel owner to the charterer of a vessel in case the cargo is loaded/unloaded at the port rapidly or much before the actual time provided in the agreement.

Now, since the transportation is of two types i.e. FOB and CIF, we will analyze the applicability of GST in each scenario.

Ocean Freight in case of FOB and CIF contracts:

1. In the case of FOB contracts, importer hires the vessel for the transportation of goods and pays the transportation charges. Such activity of transportation

carried out by the vessel owner would clearly be a **service** as the said activities cannot be said to be movable property i.e. goods as defined in section 2(52) of CGST Act. Further as the vessel owner receives consideration for the transportation activity and it will be in the course or furtherance of business, such activity would be a supply of service in terms of section 7(a) of the Act. Now let us analyze who would be liable to pay tax in this regard.

2. Generally, under the indirect tax laws, the tax is liable to be paid by the supplier but RCM is an exception to this whereby tax liability is shifted to the recipient. Under GST in pursuance of section 9(3) of the CGST Act and section 5(3) of the IGST Act, in respect of certain notified supplies, liability to pay tax is on the **recipient**. Such services are notified under **Notification No. 13/2017** Central Tax (Rate) dated 28.06.2017 and **notification No. 10/2017** Integrated Tax (Rate) dated 28.06.2017, as amended from time to time. In this regard S. No. 10 of the notification No. 10/2017 *ibid* would be relevant for examination of applicability of GST on ocean freight which is as under.

Category of Supply of Services	Supplier of Service	Recipient of Service
<i>Services supplied by a person located in nontaxable territory by way of transportation of goods by a vessel from a place outside India up to the customs station of clearance in India</i>	<i>A person located in non-taxable territory</i>	<i>Importer, as defined in clause (26) of section 2 of the Customs Act, 1962(52 of 1962), located in the taxable territory</i>

3. The term importer in terms of section 2(36) of Customs Act, 1962 (hereinafter referred to as the 'Customs Act') in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any **owner** , beneficial owner or any **person holding himself out to be the importer**.
4. From the above, it can be seen that RCM for the transportation of goods would be applicable in case if
 - ✓ Such transportation of goods is from a **place outside up to customs station of clearance in India**.
 - ✓ Supplier of services is the person located in non-taxable territory
 - ✓ 'Recipient' is the importer.
5. Further, the term 'recipient' of goods or services is defined under section 2(93) of the CGST Act to mean

- i. In case consideration is payable for the supply, the person who pays the consideration;
 - ii. In case if no consideration is payable, the person to whom the goods delivered or made available, or to whom possession or use of the goods is given or made available;
 - iii. Where no consideration is payable for the supply of service, the person to whom the service is rendered.
6. From the analysis of above provisions, it is understood that in case of FOB contracts, since importer pays **consideration** to vessel owner (person located in non-taxable territory) for transportation services in form of **ocean freight**, he would be **the recipient of the service** and all the conditions for liability under RCM will be satisfied.
7. However, in the case of CIF (Cost, Insurance, and Freight), the contract will be between the vessel owner and the foreign supplier wherein the scope of transportation is up to customs station in India but the **foreign supplier pays the consideration** thereby **making him the recipient of service**. Thereby, it can be said that in case of the CIF contracts, the actual importer **would not be liable to GST under RCM** and it is not the recipient of the services.
8. However, explanation 4 of notification No 8/2017 Integrated Tax (Rate) dated 28.06.2017 provides that
"Where the value of taxable service provided by a person located in non-taxable territory to a person located in non-taxable territory by way of transportation of goods by a vessel from a place outside India up to the customs station of clearance in India is not available with the person liable for paying integrated tax, the same shall be deemed to be 10 % of the CIF value (sum of cost, insurance and freight) of imported goods"
9. The above explanation provides the valuation mechanism in case of transportation services provided by the vessel owner to the foreign exporter. However, as per discussion above it has been concluded that the above said transaction between the foreign vessel owner and the foreign supplier would not be under the purview of GST. Hence it can be said that the above provision is **ultra vires** the Act. Further, the same has been held by Hon'ble Delhi High Court in the case of **Mega Cabs Pvt. Ltd. Versus Union of India 2016 (43) S.T.R. 67 (Del.)** *"Settled law that Rules being a subordinate legislation must confirm to provisions of main statute and must also come within scope of rule making power"*. Further, the Hon'ble Gujarat High court has stayed the IGST levy on ocean freight in case of **Mohit Minerals Vs Union of Indian 2018 (2) TMI 770**

10. However, contrary view was taken by **Rajasthan Authority For Advance Ruling, (hereinafter referred to as the 'AAR')** in case of **M/s. Chambal Fertilisers & Chemicals Limited 2018 (9) TMI 1257**, that importer would be liable to pay GST under RCM for ocean foreign in CIF contract and tax paid under RCM would be eligible for credit.
11. Hence in the case of CIF imports, the following can be the conclusions:
- In case ITC is available to recipient (i.e. dealing in taxable products)-** importer could consider paying tax under RCM for CIF contracts as well even though he would not fall under the purview of recipient of service being a revenue-neutral situation.
 - In case ITC is not available to the recipient (i.e. dealing in exempted products)-** A view can be taken that the importer is not the recipient of ocean transport service. Therefore RCM as per **notification No. 10/2017 *ibid*** would not apply.
12. Now, let us consider valuation provisions, based on which GST under RCM needs to be paid.

Discussion on valuation:

13. Generally, importer and vessel owner will not be related parties and the price as decided in the contract would be the **value of supply** in terms of section 15(1) of the CGST Act. In the event of non-satisfaction of any of the two conditions mentioned in section 15(1), reference to the Rules would have to be made in terms section 15(4) of the Act to identify the value of the supply.
14. Further, sections 15(2) and 15(3) of the Act provide certain inclusions and exclusions to the value of supply as under:
- **Inclusion**
Incidental expenses, including commission and packing, charged by the supplier to the recipient of a supply and any amount charged for anything done by the supplier in respect of the supply of goods or services or both at the time of, or before delivery of goods or supply of services.
 - **Exclusion**
*any discount which is given before or at the time of the supply if such discount has been duly recorded in the invoice issued in **respect of such supply***
- Now let us analyze the impact of demurrages paid and dispatch money received from vessel owner, on the value of supply.

Demurrage charges

15. In general, demurrage charges are the compensation charges payable to the supplier of the transportation services for **failure to load or unload the goods from the vessel within the time allowed**. Such charges are **actually incurred in relation to the transportation of the goods** by the vessel owner at the time of providing such transportation services. Hence it would be in the nature of incidental expenses incurred towards the transportation of the goods for the reason also that such charges would not be incurred unless the transportation is undertaken. Hence such demurrage charges would form part of the value of supply of the transportation services in terms of section 15(2) of the Act.
16. On the other hand, dispatch money i.e. the amount paid by the vessel owner to the charterer of a vessel in case if the cargo is loaded/unloaded at the port rapidly or much before the actual time provided in the agreement. The same will be disclosed as a reduction in ocean freight in the invoice issued. This in terms of section 15(3) of the Act could be in the nature of **discount** which has been duly recorded in the invoice issued in respect of such supply.
17. Hence it can be seen that the demurrage charges and the dispatch bonus are incurred, if any, in relation to the transportation services only and **would be an adjustment to the transportation charges incurred**. These are **not separate transactions independent** of the transportation services and thereby their taxability would be dependent on the taxability of the transportation services.
18. From the above, it can be concluded that the value on which GST needs to be paid would be
- i. **FOB contracts** - On amount paid to the shipping lines (i.e. Ocean freight + demurrages – dispatch earnings)
 - ii. **CIF contracts (if opted to pay tax)** -
 - On actual freight charges (if available), otherwise
 - 10 % of the CIF value of imported goods.

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