



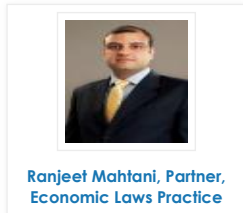
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Taxation of Ocean Freight: A Sail Through Choppy Waters

April 10, 2017

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Prior to 1st June, 2016, both, transportation of goods by vessels from outside India to India ('the import leg') and from India to outside India ('the export leg') were not liable to service tax. This was on account of coverage under the negative list (for the import leg) and non-taxability due to place of supply being outside India (for the export leg).

From 1st June, 2016, the regime was altered. The import leg was made explicitly taxable by omission of the relevant entry under the negative list regime. Export leg continued to be non-taxable. While credits opened up as regards the import leg, it did substantially increase the prices for the service providers (owing to additional tax levy of 14.5%-15%).

The tax regime also resulted in an anomaly between Indian and foreign service providers, leading to Indian service providers losing business to foreign service providers. For an import leg transaction where services are provided to a non-resident recipient, the Indian service providers are still required to charge service tax to such non-resident recipient, in the absence of any exemption thereto. However, for the import leg from outside India to India, if provided by a foreign service provider to a non-resident recipient, such services were specifically exempted in terms of entry 34(c) of Notification No. 25/2012-ST dated 20.06.2012 ("Mega Exemption Notification"). This resulted in a preference by non-resident recipients for foreign service providers over Indian service providers for import leg transactions, and loss of business for the Indian businesses.

This anomaly was remedied by Notifications No. 1/2017-ST, 2/2017-ST and 3/2017-ST all dated 12th January, 2017, effective from 22nd January, 2017, in terms of which the above exemption to foreign service providers providing services to non-resident recipients was removed for transportation services [This exemption continues even today for other services]. Further, for the reason that the Service tax authorities in India would not have a sight of the foreign service providers and also the non-resident recipient both situated outside India, the master of the vessel or the agent of the foreign shipping line who is responsible for customs filings such as Import General Manifest (IGM) in India, is deemed to be the person responsible for paying the service tax. This presents a peculiar situation where, under the law, neither the service provider nor the service recipient is made liable, rather a third person (i.e. the master of the vessel or agent of the service provider) is made liable to discharge service tax. This is comparable to the taxation of aggregator (introduced in March, 2015) where also, a party different from the supplier and the receiver is made liable to discharge the tax.

In relation to the new levy, some aspects are discussed below:

Point of taxation:

Firstly, what needs to be determined is the point of taxation. Rule 4 of the Point of Taxation Rules, 2011 ("POT Rules") would become applicable since it covers a circumstance where there is change in effective rate of duty. Rule 4 requires satisfaction of two out of three factors to happen after the date when the tax became applicable (in this case – 22nd January, 2017) – the date of provision of service, invoice and payment.

The nature of business presents complexities as regards determination of point of taxation. For instance, the original port of discharge may be a location outside India, but *en route*, this may be changed to an Indian port and in this circumstance the

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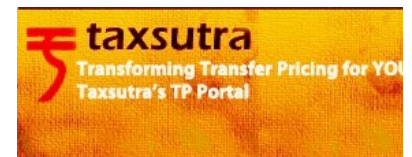
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transaction may be liable to service tax, provided that the point of taxation occurs after 22nd January, 2017. Further, the business also witnesses instances where original invoice (which may have been issued and paid prior to 22nd January, 2017) is revised subsequently (which may be after 22nd January, 2017) on account of finalization of the freight component. This may result in taxation of the additional freight component.

Specific scenarios:

In case of transshipment of goods, goods moving from a foreign location may be ultimately destined to a location outside India, though passing through an intermediary port in India. A question arises, as to whether this transaction is taxable in India. In this regard, guidance may be taken from the recent Circular no. 204/2/2017-ST, dated 16th February, 2017 ("the Circular"), issued in the context of transshipments to Nepal. The Circular clarifies that with respect to goods imported into a customs station in India intended for transshipment to any country outside India, the destination of goods is not a place in taxable territory in India but a country other than India if the same is mentioned in the import manifest or the import report as the case may be and the goods are transhipped in accordance with the provisions of the Customs Act, 1962. The Circular thus provides guidance in relation to all cases of transshipment and, with respect to such goods, services by way of transportation of goods by a vessel from a place outside India to the customs station in India are not taxable in India as the destination of such goods is a country other than India.

Another situation is that of cargo re-let. While a non-resident recipient engages a foreign service provider to provide the transportation service, the foreign service provider, in turn may engage another service provider ("the second service provider") to carry out the operations. In this case, practically, it is the agent of the second service provider who becomes liable to discharge service tax. The taxability of the original service rendered by the foreign service provider to the non-resident recipient is however is not clearly spelt out. It may be difficult for tax authorities to tax this transaction, considering that the foreign service provider may not have an agent in India, who may be required to pay the service tax on the transaction.

Procedural aspects:

One aspect that requires consideration is as regards requirement of the foreign service provider to register in India. Rule 4 of the Service Tax Rules, 1994 ("STR") requires a "person liable to pay service tax" to obtain registration under service tax law. In this case, the person liable to pay tax is the master of the vessel/ agent, and not the foreign service provider, hence, a view may be taken that the person required to obtain service tax registration is the master/ agent and not the foreign service provider himself.

Another aspect is as regards requirement to issue a tax invoice by the foreign service provider. Rule 4A of the STR casts an obligation on the "person providing taxable service" to issue a tax invoice [language being distinct from Rule 4 of the STR seen above]. One may read this provision to imply that the foreign service provider, providing taxable service, becomes liable to issue a tax invoice. However, certain details such as service tax registration number of the foreign service provider cannot be depicted, in the absence of a registration in India. It will be useful if the Central Board of Excise and Customs ("CBEC") clarifies this aspect by way of a circular.

Legal challenge:

It is noteworthy that the above amendment has been challenged before the Hon'ble Madras High Court (in W.P.No.2147 of 2017 and W.M.P.Nos.2117 and 2118 of 2017 and W.P.Nos.2148 to 2151 of 2017). *Vide* its interim order dated 30th January, 2017, the Hon'ble Madras High Court has granted protection against coercive measures to the petitioners. The final order in the matter is awaited.

The journey ahead under GST:

Goods and Services Tax (GST) may be introduced in India with effect from 1st July, 2017. Under GST, the place of supply for transportation services in relation to import leg (into India) where either the supplier or the recipient of the goods is outside India, is the destination of goods. For such transactions, the regime is comparable to the present tax regime applicable to Indian service providers. For foreign service providers, the following may be noted:

- Special provisions for registration and tax liability exist for "non resident taxable person", who is defined to include a person who occasionally undertakes transactions involving

supply of goods or services or both. Seemingly, foreign service providers providing transportation services will not qualify as a "non resident taxable person" since they undertake business not 'occasionally', but on a regular basis. There are at present no other provisions which specifically enable taxation of either the foreign service provider or the master / agent (as existing under the extant service tax regime) for import transactions.

- Therefore, the recipient will be liable to register and self-charge tax, if he is in India.
- For an Indian service provider, GST will be applicable as the transaction of import of cargo will not qualify as export of service.
- If no exemption is granted for such transactions, the levy may fail in the absence of an appropriate mechanism to locate the service provider/ recipient, if both are outside India.
- Effectively therefore, under GST, the tax position will seemingly revert back to what existed prior to 22nd January, 2017, though one can accurately determine this once the exact contours of GST are finalized.
- The fitment/ classification of goods and services under the slab rates decided by the GST Council is under way. The services which will be exempted have not yet been notified, though indications suggest that the list would be kept to the minimum.

Thus, it will have to be seen if transportation service provided by foreign service providers to non-resident service recipients are specifically exempt (as was prior to 22nd January, 2017) or otherwise.

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Comments

on April 17 2017.

Service tax rules and RCM notification have been amended on 13th April 2017 making the importer responsible for payment of taxes in these cases. Earlier, it was the responsibility of the person filing import general manifest. A huge burden on the importer.

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