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Double Whammy on Ocean Freight Cargo – Need for CENVAT Credit

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Recently the government has issued Notifications No.1/2017-ST, No.2/2017-ST and No.3/2017-ST all dated 12.01.2017 whereby the exemption available to the service provided by foreign shipping lines to the service recipient in foreign country for transportation of goods by sea, has been withdrawn. To illustrate, if General Motors, USA, engages MEC Shipping Co., USA to transport cargo from USA to India, in that case, prior to recent amendment, the said services of transportation of goods by sea was exempted in terms of Entry No.34 of the Mega Exemption Notification No.25/2012-ST. This entry provided exemption if services were provided by a person in non-taxable territory to a person located in non-taxable territory. This exemption has been withdrawn and further the amendments have also provided to make the shipping agents in India for Foreign shipping company liable to pay the service tax. The legal back up has been provided by inserting an item in clause (d) in Rule 2(1) of the Service Tax Rules, 1994 by making the said shipping agent as a "person liable for paying the service tax". Similar amendment has been made in Notification No.30/2012-ST by adding the said shipping agents responsible for paying service tax under the reverse charge mechanism.

The reasoning for this amendment, without waiting even for the budget which is likely to be presented in 10 days' time, could be understood from the grievances of the Indian shipping companies. To appreciate their problems, we need to go back to the amendments made in the last year's budget of 2016.

Negative List of services provided under Section 66D was amended in the budget 2016 whereby the "service by way of transportation of goods by an aircraft or vessel from a place outside India upto the customs station of clearance in India' was deleted from Entry (p). At the same time, such service provided by an aircraft was given exemption in Entry (53) in Mega Exemption Scheme. Notification No.25/2012-ST. The net effect of the previous year's amendment can be summarized as below:

i) If the goods were transported by an Indian shipping company from foreign country to India and if the ocean freight was paid by the foreign exporter (service recipient), the said ocean freight was taxable in the hands of Indian shipping company. These import contracts were CIF in nature for the Indian importer.

ii) If the goods were transported by Indian shipping company whereby freight was paid by Indian importer (service recipient), such ocean freight was also taxable. In fact, even prior to amendment made in 2016, such transactions were taxable in terms of Rule 8 of Place of Provision of Service Rules, 2012. These import contracts were FOB in nature for the Indian importers.

iii) If the goods were transported by foreign shipping company from foreign country to India where freight was paid by foreign exporter (service recipient), such transactions were not taxable because both the service provider (foreign shipping company) and the service recipient (foreign exporter) are located in the non-taxable territory in view of Entry No.34of the Mega Exemption.

Above analysis clearly show that the amendment made in the last budget had created an anomaly whereby Indian shipping companies who transport goods from foreign country to India were at disadvantageous position vis-à-vis the foreign shipping company doing the same activity as the later was exempted from payment of service tax. Fearing shifting of business to the foreign shipping

companies because of tax arbitrage, Indian shipping industries rushed to the government for removing this anomaly. The recent amendment made on 12/1/2017 has removed this anomaly.

However a deeper analysis of levy of Service Tax on the service provided for transporting cargo from foreign country to India throws open a bigger anomaly. It is a clear case of double taxation. On the one hand customs duties are required to be paid on CIF value which means value inclusive of freight and insurance. The ocean freight charged by the shipping companies is subjected to payment of customs duty, whether it is paid by foreign exporter (CIF transaction) or by Indian importer (FOB transaction). On the same amount of freight, service tax is also required to be paid. Is it not a case of double taxation where on the same activity two types of indirect taxes levied by the Union Government is being charged? We know that it is Govt's prerogative to tax an activity more than once but is it ethical. The double whammy could have been mitigated if the service tax paid on ocean freight was available as Cenvat credit. However, as per the present law, the service tax paid on the ocean freight is not available as Cenvat credit for the reasons given below for both the situations discussed above–

i) If the cargo is transported by Indian shipping company, they raise invoice on foreign exporter and therefore, Cenvat credit cannot be availed by importer in India.

ii) If the cargo is transported by foreign shipping company, service tax would be paid by shipping agent in India for foreign shipping company and there is no mechanism to transfer the Cenvat credit to Indian importer in this case also.

In fact, similar situation has also emerged in case of commission agents in India who are marketing the product of foreign companies in India. They are considered as 'intermediaries' in terms of the definition given in the Place of Provision of Service Rules and in terms of Rule 9 of the said Rules, even though it is a case of export of service, the Indian Agents are required to pay service tax. As they provide service to foreign companies, the service tax paid by them is also not available as credit any Indian importer or any other person and it becomes a cost in the hands of Indian agents.

Service tax being an indirect tax, the cardinal principle is to allow Cenvat credit to prevent cascading effect specially when there is B 2 B transaction. One of the option available is to allow Cenvat credit to the Indian importer when service tax is paid on the ocean freight for the goods imported by them. Enabling provisions can be made in the Cenvat Credit Rules whereby if Service Tax is paid by Indian shipping companies or by Indian agents of foreign shipping company, the actual importer can be allowed to take Cenvat credit of the service tax paid on ocean freight. This will avoid double taxation on the same activity. Even though the budget of 2017 is very near, but government should give a serious thought to amend the law after the budget and also in the GST era.