

AMTOI Advisory on Service Tax

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Note: General Advisory, contents to be applied on Case to Case basis,

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Acknowledgement

Asher & Co, Mumbai

Levy of Service Tax on Ocean Freight collection or Markup on Ocean Freight by Freight

Forwarders

The whole freight forwarding industry is in the grip of controversy with regards to the treatment of collection and or mark up on Ocean Freight collected by Freight Forwarders herein after referred to as “FF”. The Service tax authorities have and / or are in the process of issuing show cause notices to various Freight Forwarders. The Department is issuing Show Cause Notices on anyone on the grounds or category of services

- Service tax is demanded on the Markup on Ocean Freight as a taxable services under the category “Business Auxiliary Services” under the section 65(105) (zzb) read with section 65 (19) till the period 30th June 2012 and as a taxable service under Section 65B (44) post 1st July, 2012 in line with the advent of Negative list of Service tax regime
- Service tax is demanded on the Gross Ocean Freight collection as a taxable services under the category “Business Support Services” under clause 65(105)(zzzq) read with section 65 (104c) till the period 30th June 2012 and as a taxable service under Section 65B (44) post 1st July, 2012 in line with the advent of Negative list of Service tax regime

1. Activities undertaken by Freight Forwarders

- 1.1 The normal business model is to negotiate freight rates with the shipping lines and offer the same to their clients at a different rates, usually with a profit mark up, decided entirely by the forwarder in line with the market trends and as per the market forces and in no way dictated either by the shipping line or the client.
- 1.2 The freight forwarder has its own extensive marketing setup and does the marketing on its own account and in most of cases some credit is offered or negotiated by their clients. In addition the forwarders also provide service to move the cargo right from the Door Step

of the Client. It organizes transportation by rail or road from client's factory or location to the port from where it has contracted with the Ship owner or shipping line to transport the goods by sea and hand over to the client's customer or to the forwarder's counterpart in the destination country who undertakes to deliver the cargo to the client's customer's premises. There may be a written or verbal contract between the client and the forwarder. The client is naturally benefited as he has to deal with only one service provider.

- 1.3 Generally a Freight Forwarder will offer one or all the following services to a client
- Transportation of Goods from Factory to Port by Road/ Rail
 - Transportation of Goods by Vessel
 - Custom Clearance
 - Any other ancillary services depending on cargo or client's requirement
- 1.4 The Freight Forwarder will sub-contract all or part of the services to its vendor
- Transportation of Goods from Factory to Port by Road/ Rail - To Transporter or Concor etc.
 - Transportation of Goods by Vessel - Ship owner or shipping line or NVOCC or Ship manager or ship charter or slot charterer .
 - Custom Clearance - Registered CHA
 - Any other ancillary services - Vendors depending on the work required.
- 1.5 The entities are registered with the service tax authorities in the respective / applicable categories. The Service tax is charged on all expenses where the actual service provider has charged the same on FF. These companies will have mark-up on almost all the services as mentioned above.

- 1.6 The entities are registered with the service tax authorities in the categories of Business Support Services and/or Business Auxiliary Services. Whereas Service tax is charged and paid on all the activities undertaken and billed by them, the ocean freight or the margin retained by them on ocean freight is not charged with service tax.
- 1.7 Few of the Freight forwarders are also registered with Director General of Shipping as Multimodal Transport Operator (MTO) which authorizes them to issue their own shipping documents viz. Bills of Lading (B/L) / MTD. This B/L in trade parlance is known as MTD and in few cases “House B/L” and the Bills of Lading issued by the Shipping Line are known as “Master B/L”.
- 1.8 There are few Forwarders who operate as Consolidators. They generally deal in Less Container Load (LCL) Cargo. If a shipper does not have enough goods to accommodate in a fully loaded container, he arrange with a consolidator to book his cargo. This type of shipment is called LCL shipment. The said consolidator arranges a full container (FCL) with a main shipping carrier, and consoles the shipments of other shippers. Means the freight forwarder who books a full container accepts goods from different shippers and consolidates all such goods in to one container as a Fully Loaded Container - FCL. The freight forwarder sorts out these goods at destination or at transshipment points, meant for different consignees at different ports.

2. ANALYSIS OF LEGAL POSITION AND FACTS

- 2.1 Service tax was first introduced from July 1, 1994 by Finance Act, 1994 (hereinafter Act) and initially chargeable only on specified services These services were referred to as taxable services and were listed in various sub-clauses of section 65(105) of the Act. The list of services and their respective scopes were enhanced or modified from time - to - time.

- 2.2 There was a paradigm shift in the levy of Service Tax from July 1, 2012 by the introduction of a new system, popularly known as “Negative List”. After the inception of Negative List, service tax became leviable on any “service” except those mentioned in the Negative List. A definition of “Service” has been provided in section 65B (44) of the Act.
- 2.3 The two regimes of taxation are now popularly referred to as pre- and post-negative regimes. It has thus become incumbent to analyze legal issues both under the old as well as the new law.
- 2.4 There are three aspects to be analyzed
- a) Whether the collection of ocean freight from an exporter or importer constitutes an activity undertaken on Principal to Principal basis or as Intermediary.
 - b) Whether the activity undertaken would qualify as providing Business Auxiliary Services.
 - c) Whether the activity undertaken would qualify as providing Business Support Services.
 - d) Whether any Service tax is payable on the said collection or on the Mark-up or Margin.

3. Activity as Principal to Principal or Intermediary.

- 3.1 A Freight Forwarder (FF) acts on Principal to Principal Basis for the Services provided and received from the shipping companies can be decided on the following basis
- a. There is no agreement between FF and the shipping company to promote their services.
 - b. A Shipping company generally gives service only from Port to Port or ICD to Port, while a FF services are more than the shipping company provides.

- c. FF do not get any remuneration from the shipping company it is actually FF pays to the shipping company for the use of slots / space booked on their vessels.
- d. Both the shipping companies and the FF are free to decide their tariffs and quote accordingly.
- e. FF does not work on the basis of any fixed % margin or an absolute value over and above the freight rate quoted by the shipping company.
- f. FF works with numerous shipping companies and /or with other forwarders also.
- g. Till the final documents are made available to the shipping company for the purpose of finalizing the Export / Import General Manifest (EGM/IGM) and Load list, they are not aware of the type of goods or ownership of the same. They treat the FF as their clients.
- h. FF undertake to do all the work for their clients i.e. the exporter / Importer.
- i. FF's clients do not have any say in the mode, method or person with whom they subcontract certain parts of the services.
- j. The shipping companies as well as the forwarders operate in the same market place as well as compete with each other for the same clients also.

- k. As there is no agreement for services to be provided to the shipping company there is no covenant to not work with any other shipping company.
- l. FF carries the Credit risk it accords to its client, but he has to make the payment to the Shipping Companies.
- m. FF takes the burden of loss and cost overrun while booking freight for the exports.
- n. The Financial accounts of the FF also reflects Gross revenues as income and freight charges paid to shipping companies as the expense, which would not be the case if the services are provided as intermediaries.
- o. The liability to deducted Tax Deducted at Source as per the Income tax Act, 1961 on freight remitted to shipping lines is on the FF. In turn the clients deduct TDS on the amount paid to the FF.
- p. As there is no privity of contract between the Shipping line and the exporter neither the Shipping line can enforce the freight collection on the exporter nor the exporter can make the shipping line liable for any deficiency of service.

- q. Forwarders also sometime take forwarders insurance for the cargo movement handled by them including the movement of cargo by sea which is being done by shipping company as a sub - contractor to us.
- r. The FF is responsible and liable for any deficiency of service and are taking the responsibility of any civil or other consequences for a deficiency in service on their own accounts.

As can be seen from above it can be conclusively said that the shipping company is neither our client nor our principal and the relationship with the shipping company is on principal to principal basis.

- 3.2 CBEC has in the “Education Guide” at the point of explaining the definition of Intermediary for the taxability in relation to the Place of Provisions Rules, 2012 has also accepted that the fact that there are two type of freight forwarders one which acts on a principal to principal basis and one which acts as intermediary. We are reproducing the explanation offered by CBEC with regards to the Freight forwarders

“A freight forwarder provides domestic transportation within taxable territory (say, from the exporter’s factory located in Pune to Mumbai port) as well as international freight service (say, from Mumbai port to the international destination), under a single contract, on his own account (i.e. he buys-in and sells freight transport as a principal), and charges a consolidated amount to the exporter. This is a service of transportation of goods for which the place of supply is the destination of goods. Since the destination of goods is outside taxable territory, this service will not attract service tax. Here, it is presumed that ancillary freight services (i.e. services ancillary to transportation- loading, unloading, handling etc) are “bundled” with the principal service owing to a single contract or a single price (consideration).”(Source “Taxation of Services: An Education Guide issued by the Central Board of Excise and Customs”)

4 **Whether activity undertaken would qualify as providing Business Auxiliary Services.**

4.1 *Sec 65 (105) (19) of the Finance Act, 1994 defines “Business Auxiliary Service” means any service in relation to:*

- (i) promotion or marketing or sale of goods produced or provided by or belonging to the client; or*
- (ii) promotion or marketing of service provided by the client; or*
- (iii) any customer care service provided on behalf of the client; or*
- (iv) procurement of goods or services, which are inputs for the client; or*
- (v) production or processing of goods for, or on behalf of the client; or*
- (vi) provision of service on behalf of the client; or*
- (vii) a service incidental or auxiliary to any activity specified in sub-clauses (i) to (vi), such as billing, issue or collection or recovery of cheques, payments, maintenance of accounts and remittance, inventory management, evaluation or development of prospective customer or vendor, public relation services, management or supervision, and includes services as a commission agent, but does not include any activity that amounts to “manufacture” of excisable goods.*

A lot of show cause notices have alleged that FF is providing Business Auxiliary Services as per the sub-clause (iv) of the definition as mentioned above “Procurement of goods and services which are inputs for the client”.

The interpretation by the Service tax department is bereft of logic in the view of the various activities undertaken as elaborated in clause 3.1 hereinabove. As the said service is not procuring any service for and on behalf of any client, as the client is engaged the FF to undertake the activity on its own account and not as an agent.

5. **Whether activity undertaken would qualify as providing Business Support Services.**

5.1 Sec 65 (104C) “Business Support Service” means any service in relation to:

"support services of business or commerce" means services provided in relation to business or commerce and includes evaluation of prospective customers, telemarketing, processing of purchase orders and fulfilment services, information and tracking of delivery schedules, managing distribution and logistics, customer relationship management services, accounting and processing of transactions, operational or administrative assistance in any manner, formulation of customer service and pricing policies, infrastructural support services and other transaction processing.

Explanation.—For the purposes of this clause, the expression "infrastructural support services" includes providing office along with office utilities, lounge, reception with competent personnel to handle messages, secretarial services, internet and telecom facilities, pantry and security;]

Few of show cause notices have alleged that FF is providing Business Support Services as “...managing distribution and logistics”

The interpretation by the Service tax department is also bereft of logic in the view of the various activities undertaken as elaborated in clause 3.1 hereinabove. The FF does not manages distribution and logistics as it provides logistics on **it own account** and not on behalf of the client. Also it is responsible for providing the service on its own or subcontracting the same to anybody which according to the wisdom of FF is best suited to complete the work entrusted.

6. As demonstrated with the facts, where the FF provides services as a principal, the basic character of the service is ocean freight.

Ocean Freight has been treated as non-taxable services in the pre negative list regime. In the post negative regime Section 66D specifies services which are not taxable, popularly known as the negative list. As per clause p of the section 66 D

- (p) *services by way of transportation of goods—*
- (i) *by road except the services of—*
 - (A) *a goods transportation agency; or*
 - (B) *a courier agency;*
 - (ii) **by an aircraft or a vessel from a place outside India up to the customs station of clearance in India; or**
 - (iii) *by inland waterways;*

Hence all the freight collected on imports till the customs station of clearance in India is not taxable.

In case of freight collected on exports, kind attention is drawn to Rule 10 of the Place of Provision Rules, 2012

Place of provision of goods transportation services .

10 . The place of provision of services of transportation of goods, other than by way of mail or courier, shall be the place of destination of the goods:

Provided that the place of provision of services of goods transportation agency shall be the location of the person liable to pay tax.

Hence even in post negative regime, Ocean Freight has been treated as non-taxable services.

7. It follows from above that Ocean freight, transacted on a principal to principal basis, is liable to be assessed as transportation of goods service by sea. However its remains a non taxable service both in pre and post negative list regime of the law.

8. Various courts and tribunals have also prima facie taken a view that it is not taxable service and is part of ocean freight or they have taken a view it is prima facie not a taxable service. We take support from the following decisions of various courts and tribunal.

- (i) **Service Tax : Prima facie, ocean freight is not includible in value of logistics support service or 'freight forwarding' services falling under Business Support Services, provided to exporters/importers located in India** ([2015] 55 taxmann.com 364 (Chennai - CESTAT))
*APL Logistics (India) (P.) Ltd. v. Commissioner of Central Excise, Chennai-III**

Section 65(104c), read with sections 65A and 67, of the Finance Act, 1994 - Taxable services - Business Support Services - Period June 2006 to December 2008 - Assessee was providing logistics support service to exporters/importers located in India - Department sought to include ocean freight, advance manifest charges, bunkering and currency adjustment charges in taxable value - Department argued that it was a composite service and pre-dominating factor was logistics support service, which is covered under Business Support Service - HELD : Apparently, "ocean freight" was mentioned separately in invoice - It is seen from adjudication order that ocean freight, advance manifest charges, bunkering charges (fuel adjustment charges due to variation in prices) and currency adjustment charges (due to fluctuation of foreign exchange rates) are all integral part of payments, which are remitted to shipping lines - Hence, service tax is not leviable on ocean freight - In view of aforesaid, matter was remanded back to adjudicating authority for consideration afresh [Paras 8 to 10] [Matter remanded]

- (ii) **ST : In case of freight forwarders, prima facie, airfreight and ocean freight charges could not be taxed in hands of assessee by inclusion of value thereof in assessee's taxable value** [*Agility Logistics (P.) Ltd. v. Commissioner of Service Tax** [2013] 30 taxmann.com 382 (Chennai - CESTAT)]

- (iii) **Service Tax : Freight forwarders are not, prima facie, liable to service tax and even otherwise, case is arguable one; therefore, pre-deposit was reduced** [2014] 42 taxmann.com 536 (Bombay) HIGH COURT OF BOMBAY Greenwich Meridian Logistic (I) (P.) Ltd. v. Commissioner of Service Tax, Mumbai-II*
- (iv) **Service Tax : Freight collected by freight forwarders shall not form part of Business Support Services; even, 'margin on freight' earned by them arises from 'trading/commitment towards cargo space' and is prima facie not liable to service tax** [2015] 55 taxmann.com 299 (Chennai - CESTAT) CESTAT, CHENNAI BENCH Team Global Logistics (P.) Ltd. v. Commissioner of Central Excise, Chennai-II*

*Section 65(104c), read with sections 65(19) and 67, of the Finance Act, 1994 - Taxable services - Business Support Services - Stay Order - Period 2006-07 to September 2009 - Assessee was engaged in handling of export cargo and was receiving cargo and issuing House Bill of Lading - While billing charges to importers/exporters, assessee was billing air freight/ocean freight separately and paying service tax on value exclusive of freight - Department argued that freight will form part of 'Business Support Service' and in any case, difference between freight charged from customers and freight paid to carriers would be liable to service tax - Assessee argued that there is no entry to seek service tax on ocean freight and further, service tax on air freight is levied under a separate service and assessee was not providing transport services - **HELD : Freight charges towards ocean freight and air freight cannot be included in value of Business Support Service - As regards differential element of consideration between freight charged by steamer lines and freight charged by assessee to customers/exporters, : (a) there was no separate quantification in order; and (b) issue itself is debatable because assessee has an argument that this is a profit in a joint venture activity which they are having with concerned steamer agent or airlines and not by way of service because assessee is taking risk of making commitment for canvassing cargo for allotment of space - Considering prima facie case, pre-deposit was waived [Para 8] [In favour of assessee]***

9. One other aspect needs to be highlighted as to whether the said service is taxable or the Service tax department is trying to introduce a tax based on Service providers and not on the Service provided.

- 9.1 Section 65(B) (12) of the Finance Act, 1994 defines an assessee “”assessee” means a person liable to pay tax and includes his agent.
- 9.2 The Hon’ble Supreme Court of India in *All India Federation of Tax Practitioners Vs. Union of India [(2007) (7) STR 625 (SC)]* held that *Service Tax-Constitutional Validity-Services of Chartered Accountants, Cost Accountants and Architects - Levy Constitutionally Valid - Service Tax - Is A Tax on Services /Activities, Falling Under Entry 92C/97 List I - Service Tax Different From Profession Tax - Profession Tax - Is a Tax On Profession/ Status, Falling Under Entry 60, List II - Profession Will Not Include "Services" - Section 65(16), 66, 67, 68, 72, 73, 83 of the Finance Act, 1994; Section 16 of the Finance (No.2) Act, 1998; Article 246, 265, 268A, 269, 276, Schedule VII, List I Entries 92C, 97; List II Entries 60, of the Constitution of India*”

Para 16 of the said judgement

16. *Shri V Shekhar, learned senior counsel for the department, placing reliance on judgments impugned of various High Courts, submitted that "service tax" was a tax on activities undertaken for consideration; that it was a tax on services and not on the service - provider; that the tax on profession was essentially a tax on the professional and, therefore, Parliament had the legislative competence to levy service tax under entry 97 of List I. It was further submitted that with the Constitution (Eighty - eighth Amendment) Act, 2003 by which entry 92C is inserted, the controversy is closed and, therefore, there is no question of going behind the said entry which has accepted the validity of the impugned judgments by Constitutional Amendments*

[Emphasis supplied]

- 9.3 As the Hon’able Supreme Court of India as well as the Government of India through its senior counsel on behalf of the department has accepted that the levy of Service tax is on the Services and not on the Service provider, it goes against the fundamentals of the arguments raised by the service tax department with regards to the Provider of Ocean Freight services. The Service of Transportation of Goods by Sea can be provided by anybody directly or indirectly, the character of the services will not undergo any change and hence if the service is not taxable then the service will continue to remain non - taxable irrespective to the persons providing the said services.

In view of the clarification issued by the CBEC in the education guide as well as pronouncements by various Courts and CESTAT, In our view there is neither any Service tax on Ocean Freight / Air Freight nor there is any tax on difference of freight to be paid by the Freight Forwarders.

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