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Agenda for

39th GST Council Meeting

14 March 2020

Volume – 3

माल और सेवा कर परिषद
GOODS AND SERVICES
TAX COUNCIL

File No: 119/39th GSTCM/GSTC/2020

GST Council Secretariat

Room No.275, North Block, New Delhi

Dated: 20th February 2020

Notice for the 39th Meeting of the GST Council scheduled on 14th March 2020

The undersigned is directed to refer to the subject cited above and to say that the 39th Meeting of the GST Council will be held on 14th March 2020 at Hall No.2-3, Vigyan Bhawan, New Delhi. The schedule of the meeting is as follows:

- Saturday, 14th March, 2020 : 11:00 AM onwards

2. In addition, an Officers' Meeting will be held on 13th March, 2020 at Hall No.2-3, Vigyan Bhawan, New Delhi as follows:

- Friday, 13th March, 2020 : 12:30 PM onwards

3. The agenda items for the 39th Meeting of the GST Council will be communicated in due course of time.

4. Please convey the invitation to the Hon'ble Members of the GST Council to attend the Meeting.

(-Sd-)

(Dr. Ajay Bhushan Pandey)
Secretary to the Govt. of India and ex-officio Secretary to the GST Council
Tel: 011 23092653

Copy to:

1. PS to the Hon'ble Minister of Finance, Government of India, North Block, New Delhi with the request to brief Hon'ble Minister about the above said meeting.

2. PS to Hon'ble Minister of State (Finance), Government of India, North Block, New Delhi with the request to brief Hon'ble Minister about the above said meeting.

3. The Chief Secretaries of all the State Governments, Union Territories of Delhi, Puducherry and Jammu and Kashmir with the request to intimate the Minister in charge of Finance/Taxation or any other Minister nominated by the State Government as a Member of the GST Council about the above said meeting.

4. Chairman, CBIC, North Block, New Delhi, as a permanent invitee to the proceedings of the Council.

5. Chairman, GST Network

Agenda Items for the 39th Meeting of the GST Council on 14th March 2020

1. Confirmation of the Minutes of 38th GST Council Meeting held on 18th December 2019
2. Update by Infosys (through GSTN)
3. Review of Revenue Position
4. Issues recommended by the Fitment Committee for the consideration of the GST Council (Recommendations by the Committee of Officers on Revenue Augmentation)
5. Issues recommended by the Law Committee for the consideration of the GST Council
   A. Issues recommended by the Law Committee for the consideration of the GST Council
      i. Taxability of 'economic surplus' earned by brand owners of alcoholic liquor for human consumption
      ii. Challenges faced in apportionment of ITC in cases of business reorganization under section 18 (3) of CGST Act read with rule 41(1) of CGST Rules
      iii. Issue regarding waiver of penalty and interest on previous period due to removal of pre-import condition under Advance Authorization scheme
      iv. Levy of interest under the provisions of section 50 of the CGST Act, 2017 for delay in payment of tax
      v. Proposal for waiver of filing of FORM GSTR-1 by taxpayers who have availed the special composition scheme under notification No. 2/2019-Central Tax (Rate) dated 07.03.2019.
      vi. Filing of GSTR-9 (Annual Return) and GSTR-9C (Reconciliation Statement)
      vii. Proposals for amendment in the CGST Rules, 2017
      viii. Proposals for amendment in the CGST Act, 2017 and the IGST Act, 2017
      ix. Scheme of 'Know Your Supplier'
      x. Notifying NPCI, Transunion CIBIL Ltd. and Association of Mutual fund of India under section 150(1)(p) and Banking Information return under Section 150(1)(e)
      xi. Proposal for Notification / Rule change for enabling AADHAAR based authentication in GST
      xii. Clarification in respect of appeal in regard to non-constitution of Appellate Tribunal
      xiii. Exemption for certain class of registered persons from having e-invoicing along with extension of dates for implementation of e-invoicing
      xiv. Exemption for certain class of registered persons from capturing dynamic QR code along with deferment of implementation of QR Code
      xv. Agenda note for GST Council regarding extension of date of GSTR 3B filing for the month of Jan, 2020 till 31st March 2020
      xvi. Agenda note for GST Council regarding continuation of the existing system of furnishing FORM GSTR-1 and FORM GSTR-3B till the month of September, 2020

xvii. Transition Plan in view of merger of Union Territories of Dadra & Nagar Haveli and Daman & Diu

xviii. Deferring e-Wallet scheme and extending duty exemption for exporters

B. Deliberations of the Law Committee in the matter of the representation by Construction Federation of India on the orders of the Hon'ble High Court of Delhi

6. Creation of State and Area Benches of the Goods and Services Tax Appellate Tribunal (GSTAT) for the State of Uttar Pradesh

7. Quarterly Report of the NAA for the quarter October to December 2019 for the information of the GST Council

8. Deemed ratification by the GST Council of Notifications, Circulars and Orders issued by the Central Government

9. Decisions of the GST Implementation Committee (GIC) for information of the Council

10. Decisions/Recommendations of the IT Grievance Redressal Committee for information of the Council

11. Any other agenda item with the permission of the Chairperson

12. Date of the next meeting of the GST Council

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Discussion on Agenda Items

<u>Agenda Item 4(i): Inverted Rate Structure in GST-Correction of inverted rates on certain key sectors</u>

Committee of officers on Augmentation of Revenue identified Inverted Structure as a significant issue that has led to certain distortion in the GST tax regime and need correction. Inversion in rates causes accumulation of input tax credit with a manufacturer producing the goods. *Illustratively*, fabrics attract GST at the rate of 5% while its main input, i.e., yarn attracts GST at the rate of 12%. Other inputs, input services (except job work) and capital goods also attract GST at a rate higher than fabrics. As a result a fabric manufacturer would have output tax liability that is much lower than the input tax credits (ITC). Hence, a fabric manufacturer is not able to utilise the entire input tax credit. This causes accumulation of ITC with fabric manufacturers. Thus, inverted rates create distortion in GST being a deviation from the basic philosophy of a value added tax. The adverse implications of inverted rates are as follows:

(i) A manufacturer suffers cash flow issues in case of inverted rate structure, even if refund of accumulated ITC on inputs is eventually refunded.

(ii) The accumulated ITC on input services and capital goods is not refundable even if rate structure is inverted. Input services constitute significant portion of cost. Thus, accumulated ITC on input services would be significant. Accumulated ITC on capital goods is a burden for exporters too.

(iii) Small standalone units suffer more in case on account of inversion (in comparison to a large composite unit). For example, a company making fabric starting from input chemicals (making fibre and then yarn followed by fabric) would not face adverse consequence of inverted structure. On the other hand, a stand-alone power loom unit would suffer on account of inversion (from yarn to fabric).

(iv) Inverted rate structure makes import more competitive putting domestic units at disadvantage. While domestic unit suffer the adversities of accumulated ITC, the import simply enjoys lower IGST without any inversion or accumulated ITC.

(v) Inversion disincentivises capital investment. Acquisition of capital goods for manufacturer of goods suffering inversion (say fabrics) would lead to hardship for a new unit or a unit undertaking expansion of capacity, as ITC on capital goods accumulates and cannot be adjusted with output tax liability. This has been argued by industry.

(vi) A consumer is also unlikely to gain much on account of lower rate on goods suffering inversion. The embedded taxes become cost and likely to be passed on. Further, as new investment is dissuaded in such sectors, customers choices get restricted and sector remain uncompetitive/inefficient leading to adverse consequences in terms of price and availability of goods.

(vii) Even claiming refund of accumulated ITC on inputs requires effort, cost and often marred with litigation.

(viii) With technological advancement and increasing production, net unit value addition at manufacturer's end falls. Manufacturers have been outsourcing more, including the manpower supply. This makes inversion further acute.

(ix) In absence of any standardised input output norms, the inverted rate structure has also led to making fraudulent refund claim that is accumulated on fake invoice in items like footwears.

(x) Inverted rates also have serious implication to revenue as there has been substantial outgo in refund of accumulated ITC on inputs (no refund is given on input services and capital goods).

Thus, overall, inverted rate structure would make our industry less competitive, result is cash flow issues besides accumulation of ITC that sticks to cost, lead to unfair practices, creates dis-incentive for investment in newer technology and expansion, does not really benefit the consumer much in terms of cost reductions and has serious implication to revenue. Keeping these factors into account, the Committee has amongst other suggestions recommended that inverted rate structure be corrected in such a way that need for refund does not arise.

2. Subsequently, the issue was placed before the Fitment Committee in its meeting held on 6th March, 2020 wherein the Fitment Committee observed as follows:

(i) GST is a value added tax. Therefore, a supplier in an optimal tax rate structure pays tax on his value addition.

(ii) The tax suffered on inputs, input services and capital goods are available to a supplier as input tax credit (ITC). As this ITC is adjusted against the tax liability on the output, an ideal rate structure would be one in which the output tax liability is higher that the input tax. Otherwise, a taxpayer is not able to fully utilise his ITC and the accumulated unutilised

(iii) Accumulated ITC becomes cost for the manufacturer unless refunded by the government. Therefore, ideally the inputs and raw material should have lower or same tax incidence as the finished goods. However, in GST certain manufactured goods attract GST rate of 5%/12% while their inputs, input services and capital goods attract GST at the higher rate of 18% or 28%. Such a tax structure causes hardship to manufacturers. This gives rise to need for claiming refund, associated cost and efforts, and cash flow issues. Further, no refund of accumulated ITC on input services and capital goods is allowed. This brings in-efficiency in tax regime and further hardship to manufacturers.

(iv) Refining GST rate structure would not be feasible unless the inverted rate structure is corrected.

(v) Fitment Committee also took note of other relevant factors as mentioned in para 1 above.

The Committee felt that it is highly desirable that inverted rate structure is corrected by tweaking of rates in such a way that inputs suffer lower incidence as compared to finished goods. The Committee felt that to begin with inverted rate structure could be corrected on mobiles, footwears, textiles etc. It has also been is felt that such corrections may also be desirable in fertilizers. Together these four sectors, along with associated services and inputs accounts for about 3/4th of inversion going by the refund claimed amount.

3. After detailed deliberations, the Committee makes the following recommendations.

4. **Mobile Phones:** Cellular Mobile phones attract 12% GST rate. Further, parts falling under chapter 85 used in the manufacturing of Cellular Mobile Phones also attract 12% GST rate. In effect, parts falling under Chapter 85 have dual rate and a manufacturer has option to procure these inputs at 18% or 28% as the case may be. All other parts (like plastic, rubber and metal parts like mechanics etc.) attract GST at the rate of 18%. Further, input services and capital goods also attract GST at the rate of 18%. Thus, there is an inverted rate structure on mobiles and their manufacturers are claiming refund of accumulated ITC. As per the data available, the total refund amount of about Rs. 5500 Crore (approx.) has been claimed so far by mobile manufacturers (July 2017-till date).

4.1 The GST rate on mobile phone was prescribed taking into account that in pre-GST era there was a dual rate of central excise rate on mobile. This was done to promote domestic manufacturing of these items. Under dual excise scheme, a manufacturer has two options for excise rate: - (i) Basic Excise Rate (BED) @ 1% without CENVAT Credit, and (ii) BED @ 12.5% with CENVAT credit. This was done to incentives domestic value addition. In central excise there was no provision for refund of input tax credit on account of inverted rate structure. During the discussion on rates of cellular mobile phones in the 14th GST Council meeting held on 18th and 19th May, 2017, there were divergent views. While some of the Members favoured standard rate of 18% on mobile, the other argued for a lower rate of 12% based on pre-GST incidence, digitalisation and for promoting further penetration of mobiles. It was eventually decided to keep the rate on mobile phones at 12%. Since then, domestic mobile manufacturing has grown rapidly and now domestic manufacture is in excess of 2 Lakh Crore (estimated) in the Year 2019-20 and, its total consumption value (including spare parts) would be about of Rs 2.5 lakh crore. The consumption has been increasing. About 29 crore phones are now made domestically. Thus, on maturing of domestic manufacturing, it would be desirable that inverted rate structure is corrected and this significant consumer item should be standard rated along with its parts.

4.2 During the Fitment Committee the need for retaining the present GST rate of 12% on the low-cost push-button type phones/feature phones was also deliberated upon. The Fitment Committee was of the view that keeping 12% GST rate on push button type feature phone is not desirable based on the following reasons, namely: -

(i) With increase in production the margin of manufacturer on per unit of phone squeezes. As such service element in electronic manufacturing is increasing beside increasing capital infusion as innovation in technology happen. Push button type mobile will have even thinner margin. Therefore, inversion is a serious issue of manufacturer of such phone.

(ii) Feature phones are low value items. Therefore, rate calibration to 18% would not have significant impact on prices. On another hand correction of inversion would have help manufacturers in utilising their ITC on inputs, input services and capital goods fully, thus have softening impact on prices.

(iii) Keeping GST rate of 12% on feature phones will not resolve the issue of inversion which is the primary objective of this whole exercise.

(iv) Having a dual rate leads to distortion and evasion. As such common manufacturing facility may be used for manufacture of both kinds of phones.

(v) Inverted structure promotes the imports and disincentives the exports as the importer will not have to suffer the cost of unutilised credit. Further, Indian manufacturers have started exporting the feature phones also. In the period April, 19-Januray, 2020, total exports of the feature phones from India was around Rs. 2000 Crore. Even in the interest of exports, it is desirable to correct inversion.

4.3 Accordingly, based on the above discussion, Fitment Committee recommends that the GST rate on mobile phones and its parts (falling under Chapter 85) may be increased from 12% to 18% (on par with other consumer goods items) in order to remove the inversion in rates on the mobile phones.

5. **Footwear**: India produces more than 2 billion pairs of different categories of footwear. Over the year the percentage of non-leather footwear has been increasing and at present non-leather footwear constitutes about 60% of the total footwears made. Even in leather footwear as significant constituents (like soles, consumable, embellishments etc.) is of non-leather items. Hence, non-leather inputs, as discussed below are the major constituents of footwear industry. There are nearly 15000 units engaged in manufacturing footwear in India with total turnover of these manufacturing unit is estimated at Rs. 70,000 crores. The value addition in this industry is about 15-20%. With post manufacturing (trading) value addition and imports of footwear, the total domestic consumption

estimated to be about Rs 80,000 crore a year. As the major constituents of footwear industry attract standard rate (except leather-cost of which on an average is about 20% in leather footwear), the inversion in footwear with 5% rate is acute.

5.1 While pre-GST tax incidence on footwear was significantly higher (ranging from 10% to 29%), the GST Council recommended a lower dual rate structure for footwear with 5% rate on footwear with retail sale price up to Rs. 500 and 18% on other footwears. The Council revisited the rate structure on footwear and concessional rate of 5% was extended up to footwear with retail sale price upto Rs. 1000 with effect from August, 2018. Subsequently, w.e.f. 1.1.2019 further concession was given to footwear and GST rate would apply on the supply value rather than on the basis of retail sale price.

5.2 This has led to inversion in rate structure, as majority of sale of footwear (about 70%) is at concessional GST rate of 5%. The major inputs of footwear and their typical share in a footwear are as under:

Parts	**Material**	**GST rate**	**Proportion in Cost**
Shoe Sole	Natural/Synthetic Rubber, Precipitated Silica, Elasto Polymer	18%	25%
Shoe Upper	Leather, Technical Textile, Rubber, Plastic	5%/12%/18%	30%
Chemicals, components, embellishments, other Parts, Consumables and other inputs	Adhesives, [PU, polychloroprene, PVA, Acrylics, Isocyanate], Solvents [MEK], Colors and Pigments, Catalysts etc.	18%	15%
Overheads and other expenditures (Capital goods, input services)		18% on capital goods and input services (other than job work)	25%
Margin			5%

Source: Industry data

5.3 The refunds generated due to inverted rate structure in Footwear sector on footwear attracting concessional GST rate of 5% from July 2017 to January, 2020 is to the tune of Rs. 2500 crore.

5.4 In general Fitment Committee has been of the view that dual rate structure needs to be avoided as it creates distortion and leads to mis-declaration/ evasion of taxes. As such an advalorem rate ensures that in absolute term the lower segment would suffer lesser tax incidence. Therefore, ideal all footwear should be standard rated. However, considering that the items is a mass consumption goods, at this stage 12% rate for footwear with value upto Rs.1000/- per pair may be conducive to correct inversion. The Fitment Committee recommends accordingly. Thus taking all factors into account

6. **Textiles**: The GST rate structure on all goods of the textile value chain was deliberated at length during the 15th meeting of the GST council held on 03.06.2017 and subsequent GST Council meetings. Based on the Pre-GST tax incidence, the GST Council recommended: -

(a) 18% GST on Man-made fibres
(b) 18% rate on MMF filaments and yarns,
(b) 5% GST on cotton, silk, wool and other natural fibre and yarns
(c) 5% on raw cotton and other vegetable fibres; nil rate on raw silk, raw wool and raw jute.
(d) 5% on all apparel fabrics including Man-made fibre fabrics with restriction on refund of accumulated ITC at fabric stage.
(e) 12% rate on technical and other fabrics such as narrow fabrics.

6.1. In pre-GST regime fabrics suffered a much higher tax incidence. While cotton fabric had an incidence of about 9%, MMF fabrics had an incidence of about 13.6%. Therefore, a 5% rate in GST was much lower. Taking this into account Council prescribed the restriction of not allowing refund of accumulated ITC on fabrics. After roll out of GST, the textile industry represented that the rate structure resulted in acute inversion if textile sector particularly at fabric stage. It was also argued that the restriction of not allowing refund of accumulated ITC on fabrics favoured large composite mills while standalone power looms suffered. Accordingly, in stages further relief was extended to textile sector. To begin with GST rate on manmade yarn was reduced to 12%. Thereafter, refund of accumulated ITC was allowed on fabrics with prospective effect from 1.8.2018. Job-work services were also brought down to 5%. However, these changes have not been able to sort out the inversion issues. Yarn continues to suffer significant inversion as value addition from fibre to yarn is not significant. Hence, standalone spinning units suffer. Fabric continues to have inversion on account higher tax rate on yarn, input services and capital goods. The adverse impact of inverted rate structure has bearing to ready-made garment segment too on account of accumulated ITC on services and capital goods. Also the cost associated with inversion on fabric becomes a cost that is transferred by fabric manufacturer to readymade garments.
6.2 On ready-made garments the pre-GST incidence was about 13.2%. Hence, 5% rate in GST is significantly lower.

6.3 Lower rate of 5% on job-work has led to hardship to dyeing units. Their significant inputs like chemicals and dyes attract GST at the rate of 18%. Further critical input services of effluent treatment attract GST at the rate of 12%. These job workers have been representing for correcting inversion even if it requires increasing rate to 12% of dyeing services.

6.4. Ministry of Textiles has recommended for correcting inverted rate structure so as to un-shackle it from the burden of taxes (accumulated ITC etc). It has been stated that liberating this sector will also substantially increase employment opportunities in the textile industry. The differential rates and slow-refunds of accumulated input tax credit has affected the competitiveness of the industry and has proven to be a deterrent for investment in the sector. Ministry of Textile is of the view that for tax uniformity across the value chain, MMF fibres and yarns need to be brought under a uniform tax slab to take care of inversion in tax structure. This will benefit the spinning and power loom sectors, which in turn will boost the garment sector and create huge job opportunities. An inter-Ministerial Group (IMG) consisting of Ministry of Textiles, Commerce and NITI Aayog has also viewed similarly. The IMG has observed that with implied limitation on growing cotton, man made fibre base needs to grow atleast 5 times in next 5 years.

6.5 The inversion in rate structure of textile sector has led to a refund of about Rs 4000 crore. This is anticipated to grow considerably in future considering that in the first year, refund of accumulated ITC was not allowed to fabric units.

6.6 The volumes of quantity produced and sold for textile sectors broadly are as follows. Cotton yarn - 4200 Mn Kg, man-made fibre and yarn- 3600 Mn Kg, fibre being about 1200 Mn Kgs,-fibre being about 1200 Mn Kg. Over 26,000 Mn sqm. fabrics are produced out of manmade yarn (Source DC&PC, Textile Commissioner). In coming years, the man-made segment is anticipated to grow faster than natural fibre segment.

6.7 Fitment Committee examined the above issue of inversion in the textile value chain in its meeting. General view as regards GST rate structure in textile sector is that the 5% rate on fabrics and lower value garments (Rs 1000 per pc) is an anomaly. Manufactured goods should either have higher or equal rate (in comparison to the rate as applicable to key inputs). However, a divergent view offered was that the output tax rate on mass consumption commodities like garments and fabrics should be viewed from the point of view of the consumer interests and not solely from the view of industry hardships or inversion. On this count any increase in rate of fabric and garment may not be justifiable.

6.8 Fitment Committee deliberated in detail on this issue. Fitment Committee also dwelled on the issue as to the impact of any calibration of GST rates on fabrics or garments on the end consumer. It was observed that in the meeting that the GST Council had recommended a lower rate of 5% on all fabrics and lower segment garments on account of acceptability of GST rate and essential consumption nature of the item. However, the experience since the roll out of GST has been that inverted rate structure has led to significant adverse impact as stated in para 1 and 2 above. It has not really benefitted the consumer either. Lower incidence did not lead to reduction of prices of fabrics or garments. In any case, inversion of tax rate meant that a lot of cost on account of accumulated ITC on services, capital goods and the resource cost for seeking refund of accumulated ITC on input sticks to the cost of fabric and garments. This may be 4-5% considering service and capital goods would at least constitute 20-25% of the input cost. Further, removal of inversion would give boost to the garment sector and with increasing production customer would only benefit. Therefore, increase in tax rates may at the most a marginal effect of garment. Besides, there exists a strong economic justification, as argued by Ministry of Textiles, that refined rate structure will help the sector to grow at faster pace.

6.9. In this background the Fitment Committee discussed the possible solutions to address the issue of inversion in the textile value chain. While doing so, it was kept in mind that input chemicals, capital goods and input services, other than job work, and inputs like buttons, dyes etc are at 18% and hence, a low rate of 5% on MMF, fabrics and garments would not help the sector. It was felt that at garment or fabric stage it is not feasible to differentiate the natural fibre and MMF. In any case blended fabric is quite common. Therefore, Fitment Committee was of the view the output tax rate on fabrics and garments/made-up should be prescribed at a uniform level of 12%. It was also discussed that as per the recommendations made by the Ministry of Textiles and IMG, the GST rate on fibres should be lowered to 12% to bring them at par with yarns to avoid inverted rate structure at yarn stage. As the value addition at the fibre stage is significant (e.g., while import parity price of PTA - input for polyester is about Rs 50 per kg, the import parity price for fibre is about Rs 100 per Kg), the fibre manufacturer shall not suffer adversely on account of inversion.

6.10 The Fitment Committee also observed the dyeing industry has also been severely affected by inversion as the output service attract GST rate of 5% while their significant inputs like dyes attract GST at the rate of 18% and significant services like effluent treatment also attract a GST of 12%. This industry has represented for correction of inversion by raising GST rate on the process of dyeing from

5% to 12%. Once the fabrics rate is calibrated to 12%, it would also be feasible to calibrate the GST rate of dyeing industry. Fitment Committee is also of the view that dual rate on readymade garment and made ups be avoided. RMG and made up, irrespective of value be placed at uniform rate of 12%. Advalorem rate would ensure that lower rate garment suffer lower tax in absolute terms. As stated, rate calibration shall not have any significant implication to consumer. In long run, as sector grows, it would benefit consumers and economy as streamlining of the tax structure textile industry would be able to grow at a more rapid pace and with increased productions and economies of scale, the costs and prices in this sector would naturally go down.

6.11 In view of the above discussions, the Fitment Committee proposed the following rate structure on textiles: -

(a) 5% GST on cotton and other natural fibres (except raw jute, silk and wool) and all-natural fibre yarns.
(b) 12% GST on manmade fibres
(c) 12% GST on MMF yarns
(d) 12% GST on all fabrics
(e) 12% GST on all garments and made-up
(f) 12% GST on dyeing services

7. **Fertilizers:** All fertilizers attract GST at the rate of 5%. The major category of fertilizers is urea, DAP, NPK and ammonium sulphate. Total consumption of fertiliser is about 60 million tonnes in a year. Urea constitutes major consumption at about 30 million ton. Consumption of DAP and NPK is about 10 million tonnes each. SSP and MoP constitute the remaining. Domestic production is about 41 million ton. Subsidised value of fertilizer consumed is estimated to be about Rs 80000 crore, while total value is about Rs. 1.5 lakh crore (including subsidy). Fertilizer thus remains a highly subsidised and controlled price product.

7.1. In the original rate structure, fertilizers were placed under the 12% GST bracket. However, many states raised the demand to reduce the GST rate on fertilizers to support the agricultural sector. It was also mentioned that natural gas, a major input for fertilizers, remains outside GST. The total pre-GST tax incidence on fertilizers, including central excise, tax on inputs, average VAT, CST, octroi, etc, was estimated to be about 9.75%. Ultimately, a consensus was reached in the Council (in the 18^{th} meeting held on 30th June- i.e., just before the roll out of GST) that GST rate on fertilizers be fixed at 5%.

7.2 Subsequently, fertilizer manufacturers claimed that inverted tax structure was leading to hardship to them in terms of cash flow. Accordingly, the Council, after detailed deliberation reduced GST rate on phosphoric acid from 18% to 12% and then eventually to 5% to address the inverted duty structure to certain extent. However, inverted rate structure has still not been resolved completely. Accordingly, demand has been to lower rate on other inputs like ammonia and sulphuric acid. Considering that GST rate on services and capital goods is 18% rate, a rate cut on input would not fully resolve the issue of inversion.

7.3. As per the data available, a total of Rs. 6000 crores have been claimed as input tax credit refund on fertilizers from July, 2017 till date. With reduction of GST rate to 5% on phosphoric acid the inversion has reduced. However, other inputs like sulphuric acid, ammonia, potash etc, input services and capital goods are still at 18%. Therefore, significant inversion still remains. More so on account of input services and capital goods, which is not even refundable. In view it is desirable that the inverted rate structure is corrected in fertilizers. This could be achieved by raising GST rate on fertilisers to 12%. Fitment Committee recommends accordingly.

7.4 While making recommendation, the Fitment Committee has been conscious of the fact and dwelled upon the aspect as to the impact of rate calibration. As stated, an inverted rate structure helps none in a mature industry, neither the manufacturer nor the consumer. It creates distortion in the tax regime, causes hardship in terms of cash flow for domestic manufacturing and leads to cost built up on account of ITC that is not usable. A big domestic industry of this kind should have a non-inverted rate structure. Therefore, seamless ITC chain with full ITC flow, which industry could utilise timely, shall ensure investment, production growth, efficiency and cost reduction. In any case full ITC utilisation would ensure that basic cost is reduced. Thus, a consumer would not be adversely affected on account of calibrated GST rate wherein fertilizer is placed at 12%. This would make tax regime simple, transparent and avoid the requirement of refunds on account of inverted structure. As such fertiliser is subsidised and controlled price product. Suitable calibration is feasible.

7.5 In view of the above, the Fitment Committee recommends that all chemical fertilizers be placed in the 12% slab.

Agenda Item 4(ii): Agenda for GST Council Meeting on 14th March, 2020- in relation to supply of services

Recommendations made by the Fitment Committee in the meeting held on 6th March, 2020 in relations to services.

<table>
<tr><th>Sl. No.</th><th>Proposal</th><th>Recommendation of Fitment Committee</th></tr>
<tr><td>1.</td><td>Representations of Haj/ Umrah Private Tour Operators (PTOs) to exempt/not levy GST on the Haj/ Umrah tours organized and conducted by the Haj Group Operators (HGO) formerly known as Private Tour Operators.

The Hon'ble SC vide order 11.12.2019 has allowed the petitioners to withdraw their petitions and directed the government to decide on the representation of the PTOs within 90 days of the order.</td><td>Recommendation: Agreed

Request may not be acceded to.

As per the direction of the Hon'ble Court representation of the PTOs has been examined. The request for issuing a clarification that the service of conduct of haj/ Umrah tours by Private Tour Operators is not taxable or to exempt the same has no merit as discussed in detail in the annexure I placed below.</td></tr>
<tr><td>2.</td><td>To provide level playing field to domestic MROs vis-à-vis foreign MROs by reducing GST on MRO services to 5% with full ITC and change PoS for B2B MRO Services to Location of Recipient.</td><td>Recommendation: Agreed except by Maharashtra.
i. GST on MRO services in respect of aircraft may be reduced to 5% with full ITC.
ii. PoS for B2B MRO Services in respect of aircraft may be changed to Location of Recipient. [notification may be issued u/S 13(13) of the IGST Act]
A note on analysis of the issue and solution is enclosed as annexure II.</td></tr>
<tr><td>3.</td><td>To provide level playing field to Indian Shipping lines in light of the order dated 23.1.2020 of the High Court of Gujarat in the case of M/s. of Mohit Minerals Pvt. Ltd by changing the PoS of goods transport service from the place of destination of goods to the location of recipient.</td><td>Recommendation: Deferred for further discussion.

Detailed write up on the issue is enclosed as annexure III.</td></tr>
<tr><td>4.</td><td>Proposal to tax job work service in relation to manufacture of alcoholic liquor for human consumption @ 18%</td><td>Recommendation: Most of the members of the Fitment Committee agreed to the following proposal. However, Tamil Nadu and Maharashtra expressed a different opinion.

(a) services by way of job work in relation to manufacture of alcoholic liquor for</td></tr>
</table>

Sl. No.	Proposal	Recommendation of Fitment Committee
		human consumption may be excluded from the residual entry for job work service at 9988 (id) prescribing 12% rate of GST and taxed at 18% as has been done in case of job work related to bus body building. (b) An explanation may be inserted at entry 9988 (i)(f) of the notification no 11/ 2017- CTR which prescribes GST rate of 5% for job work services in relation to food and food products as under "Explanation-For removal of doubts it is clarified that food and food products excludes alcoholic beverages for human consumption". Detailed write up on the issue is enclosed as **annexure IV.**

Annexure- I

Subject: Representations of Haj/Umrah Private Tour Operators (PTOs) to exempt/not levy GST on the Haj/Umrah tours organized and conducted by the Haj Group Operators (HGO) formerly known as Private Tour Operators- reg.

Hon'ble SC vide order 11.12.2019 has allowed the petitioners to withdraw their petitions and directed the government to decide on the representation of the PTOs within 90 days of the order. As per the direction of the Hon'ble Court representation of the PTOs has been examined.

The petitioners have requested to exempt/not levy GST on the services of organizing and conducting Haj/Umrah tours on following grounds: -

(1) Place of supply of Haj/Umrah tours is outside India. CGST/SGST Acts are applicable only to whole of India. Therefore, it may be clarified that tours being organized outside India are not taxable.
(2) The Haj/Umrah tours are covered Sl. No. 13(a) of Notification No. 12/2017-CTR and Sl. No. 14a of Notification No. 9/2017-ITR, which exempts *services by a person by way of conduct of any religious ceremony*. Haj and Umrah are religious ceremonies of Islam and it is organized by HGO [PTO].
(3) GST exemption [Sl. No. 60 of Notification No. 12/2017-CTR and Sl. No. 63 of Notification No. 9/2017-ITR] has been granted only to the pilgrims for whom Haj Committee of India organizes the Haj/Umrah pilgrimage and not for the pilgrims for whom HGO [PTO] organizes and conducts the pilgrimage. It is discriminatory and violative of Article 14 of the Constitution of India.

The issues/grounds raised by the HGO [PTO] in the representations have been examined below:

Ground 1: Place of supply of Haj/Umrah tours is outside India. CGST/SGST Acts are applicable only to whole of India. Therefore, it may be clarified that tours being organized outside India are not taxable.

The foremost principle followed world over in levy of consumption taxes like Service Tax, VAT, GST is that they are borne by the consumer, and are taxed by the jurisdiction where the consumer belongs. This is the reason that in all major VAT jurisdictions, the general rule to determine the place where supply of service is consumed or supplied is that the place of supply of service will be the place where the recipient of the service is located. Exceptions may be made where the service recipient or service provider belong to different countries. The exceptions are generally aimed at avoiding double- taxation or double non-taxation of a service or to ensure that the procedural compliance burden of a tax does not fall on an individual. Such exceptions are not required where both the supplier of service and the recipient of service are located in the taxable territory.

The general rule for determination of place of supply based on location of the recipient of service ensures that service tax/ GST levied on service provided by a tour operator located in Delhi to a service recipient residing in Bihar accrues to the State of Bihar, the resident of which has borne the tax on that service. This is the essence of a destination based consumption tax, which GST is. This rule also ensures that a service consumed, enjoyed and paid for by a resident in India is taxed by the Indian jurisdiction. Not taxing service of outbound tour provided by a tour operator located in India to a service recipient located in India would lead to double non taxation; the service would neither be taxed in India nor by the country in which the tour is conducted.

The tour operators have cited in support of their contentions, the CESTAT judgments in the case of M/s Atlas Tours and Travels and M/s Cox and Kings India Limited,. However, the judgments in the case of M/s Atlas Tours and Travels and M/s Cox and Kings India Limited relied upon are not relevant in Service Tax period, post 01.07.2012 or for GST due to following reasons –

In the Service Tax period prior to 01.07.2012, 'tour operator service' was defined in such a manner that it required the tour to be operated in a 'tourist vehicle' covered by a permit granted under the Motor Vehicle Act 1988. In 2004, the definition was expanded to cover planning, scheduling, organizing or arranging tour by any mode of transport but the definition of tour operator was so structured that it led the Tribunal to conclude that the definition has been expanded only to cover one facet of the service namely, of planning, scheduling or arranging tours, by any mode of transport. Operating of the tour, per se was still excluded from the expanded definition and it still required the tour to be operated in a 'tourist vehicle' covered by the permit granted under the Motor Vehicle Act, 1988. Based on this interpretation, the Tribunal held that the outbound tours which do not have any component of travel in a vehicle covered by a permit granted under Motor Vehicle Act, 1988 was not covered by the tour operator service. Prior to 01.07.2012, Service Tax could be levied only on specified services. Once an activity was excluded from the scope of a specified taxable service, it could not be taxed.

However, with effect from 01.07.2012, the concept of comprehensive taxation of services based on a negative list of services was ushered in. All services, which did not figure in the negative list or were not specifically exempted, became subject to Service Tax. Tour operator service neither figured in the negative list of services nor was exempted. Therefore, with effect from 01.07.2012 the taxability of service provided by a tour operator was not contingent upon the service fitting in any specified description or definition.

Further, for the purposes of Notification No. 26/12 – Service Tax dated 20.06.2012, which granted partial exemption to services provided by a 'tour operator', was defined tour operator as *"any person engaged in the business of planning, scheduling, organizing, arranging tours [which may include arrangements for accommodation, sight-seeing or other similar services] by any mode of transport and includes any person engaged in the business of operating tours".* Therefore, with effect from 1.7.2012, the tour operator service was not restricted to a tour operated by a vehicle covered by a permit granted under Motor Vehicle Act, 1988.

In the pre-2012 period, the Department had itself clarified vide circulars/trade notices that tours conducted outside India were not taxable. It was only in 2007 that the Board conveyed vide letter dated 12.10.2007 to Commissioner of Service Tax, Delhi that the service provided by a tour operator located in India to a recipient, who is also located in India, for planning, scheduling and organizing in relation to a tour outside India (outbound tourism) would be taxable under the category of "Tour Operator Service". This view is based on the fact that service provider and service receiver, both, are located in India and the service flows within the country. Accordingly, the place of supply of service is India, and hence, the service is taxable. This view was in line with the international practice of taxation of destination based 'consumption tax' and the principle that consumption tax should be borne by the final consumer and the tax should accrue to the jurisdiction to which the consumer belongs. However, this view was not backed by an explicit provision in law at that time. Section 66 of Finance Act, 1994, which was the charging section at that time provided that Service Tax shall be levied on the services specified in Clause 105 of Section 65 of the Finance Act, 1994. The section 64 of the Finance Act, 1994 provided that the provisions of Service Tax extended to whole of India except the State of J&K. There was no provision in the Act, which provided for determination of the place where the service was supplied.

However, with the advent of negative list system of taxation of services w.e.f. 1.07.2102, key provisions of the Finance Act, 1994 underwent a complete change. The erstwhile charging Section 66 was deleted and replaced with Section 66 B which provided that Service Tax shall be levied on all services provided or agreed to be provided in the taxable territory by one person to another. The words *"provided or agreed to be provided in the taxable territory"* in the new section are noteworthy. Linked to these words was the provision in Section 66C of the Finance Act, 1994, which also became effective from 01.07.2012. Section 66C empowered the Central Government to determine the place where the service is provided or deemed to have been provided, having regard to the nature and description of various services.

In exercise of powers under Section 66 C of the Finance Act, 1994 the Government notified the Place of Provision of Service Rules vide Notification No. 28/12 – Service Tax dated 20.06.2012. These rules were framed keeping in view the internationally followed principles for determination of place of supply of service. In accordance with the international practice and OECD guidelines in this regard, the general rule or the default rule for determination of place of provision of service was that the place of provision of service shall be the place where the recipient of service was located (Rule 3 of the Place of Supply of service). Further, Rule 8 of the said rules provided that place of provision of a service, where the location of the provider of the service as well as that of the recipient of services is in the taxable territory, shall be the location of the recipient of service. These rules were notified in due exercise of powers expressly given by the Finance Act, 1994. The place of supply of service provided by a tour operator located in India to a person located in India (Hajis) was in India following either the default rule (Rule 3) or Rule8 of the said Rules. Accordingly, the provision of service was in the taxable territory and thus clearly liable to Service Tax w.e.f. 1.07.2012.

The same provisions continued in GST, which came with effective from 01.07.2017. According to Section 12 of the IGST Act, 2017, the place of supply of services, except specified services, provided by a person located in India to a recipient of service located in India, is the location of recipient of the service. The services provided by a tour operator are covered by this general rule. In view of the above, the rulings in the case of M/s Cox and Kings, M/s Travel Corporation of India Ltd. Etc. are not relevant after 0.07.2012 for Service Tax or GST purposes.

<u>Extra Territorial Applicability of Law</u>

It is a settled law that the Parliament is empowered to make laws with respect to aspects or causes that have an impact on or nexus with India. [Supreme Court judgment in GVK Industry Limited [(2011) 4SCC36 refers]. The provisions in question do not have any extra territorial applicability. The tour operators are located in India, the service recipients are located in India, and the service is consumed, enjoyed and paid for by the recipients located in India. Therefore, the provisions have a direct impact on and nexus with India and Indians.

Ground 2: The Haj/Umrah tours are covered Sl. No. 13(a) of Notification No. 12/2017-CTR and Sl. No. 14a of Notification No. 9/2017-ITR, which exempted services by a person by way to conduct of any religious ceremony. Haj and Umrah are religious ceremonies of Islam and it is organized by HGO [PTO].

The word 'religious ceremony' is not defined in Service Tax or GST laws. However, as per the Service Tax Education Guide, religious ceremonies are life-cycle rituals including special religious poojas conducted in terms of religious texts by a person so authorized by such religious texts. Occasions like birth, marriage, and death involve elaborate religious ceremonies. The activity of HGO [PTO] of conducting tours on commercial basis for Haj/Umrah pilgrimage is a commercial activity undertaken by tour operators and not a religious ceremony; and hence, not eligible for the exemption under Sl. No. 13a of Notification No. 12/2017-CTR and Sl. No. 14a of Notification No. 9/2017-ITR.

Services provided by a specified organization in respect of a religious pilgrimage facilitated by the Ministry of External Affairs of the Government of India, under a bilateral arrangement, have been given specific exemption from GST vide Sl. No. 60 of Notification No. 12/2017-CTR and Sl. No. 63 of Notification No. 9/2017-ITR. Had conduct of tours for Haj/Umrah pilgrims been a religious ceremony, there was no need to provide a separate exemption entry for Haj/Umrah pilgrimage facilitated by Government of India.

HGO [PTO] are not conducting a religious ceremony but acting as commercial entity organizing tours for persons, who wish to take journey to Saudi Arabia for Haj/Umrah. Tour operator services for conduct of religious pilgrimage of various religions, both within and outside India, is taxable under GST. Examples include tour operator service for Kashi Yatra, Chardham Yatra, Krishna Temple in USA, Buddhist Temple in Nepal, Japan etc.

Ground 3: GST exemption [Sl. No. 60 of Notification No. 12/2017-CTR and Sl. No. 63 of Notification No. 9/2017-ITR] has been granted only to the pilgrims for whom Haj Committee of India is organizes the Haj/Umrah pilgrimage and not for the pilgrims for whom HGO[PTO] organizes and conducts the pilgrimage. It is discriminatory and violative of Article 14 of the Constitution of India.

Services provided by a specified organisation in respect of a religious pilgrimage facilitated by the Government of India, under a bilateral arrangement, is exempt from GST. "Specified organizations" are Kumaon Mandal Vikas Nigam Limited, a Government of Uttarakhand Undertaking and 'Committee' or 'State Committee' as defined in section 2 of the Haj Committee Act, 2002 (35 of 2002).

GST is leviable on tour operator service for organizing Haj/Umrah pilgrimage tour. GST exemption is available only on services of religious pilgrimage facilitated by Central govt. or State govt. under a bilateral arrangement. There is no exemption available to services of religious pilgrimage of any religion provided by any private tour operator. Therefore, existing exemption available on services of religious pilgrimage facilitated by Government of India is not discriminatory. The legislature intends to exclude private tour operators from the purview of Service Tax/GST exemption. Catena of court judgments have upheld that legislature has wide latitude in taxation to choose the subject and people to be taxed.

Article 14 prohibits class legislation and not reasonable classification. It is very much within the powers of legislature to categorize goods and services for the purpose of taxation in such manner as meets the policies and objectives of the government. The legislation intends to differentiate between tour operator services rendered by public and private entities. There is no discrimination between religious pilgrims. All pilgrims who undertake Haj/Umrah pilgrimage or any other religious pilgrimage through private tour operators are treated equally.

The Constitutional bench of Supreme Court in R.K. Garg v. Union of India(1981) 4 SCC 675, laid down the test of classification by reference to article 14 was as under –

"The clarification must not be arbitrary but must be rational, that is to say, it must not only be based on some qualities or characteristics which are to be found in all the persons grouped together and not in others who are left out but those qualities or characteristics must have a reasonable relation to the object of the legislation. In order to pass the test, two conditions must be fulfilled, namely, (1) that the classification must be founded on an intelligible differentia, which distinguishes those that are grouped together from others, and (2) that differentia must have a rational relation to the object sought to be achieved by the Act."

The classification of pilgrims undertaking Haj/Umrah pilgrimage tours through Haj Committee of India under bilateral arrangement and those undertaking tours through private tour operators is based on an intelligible differentia having a rational relation to the object sought to be achieved by the statute in question. Therefore, services Tax/GST exemption on services provided by a specified organization in respect of a religious pilgrimage facilitated by Government of India under bilateral arrangement are not discriminatory and not voilative of Article 14 of the Constitution.

As discussed above, the service of organizing and conduct of tour for Haj/Umrah pilgrims by private tour operators is taxable under GST. It is not covered under any of the existing exemptions from GST. Therefore, the request to not levy GST or to clarify that GST is not leviable on the same is not acceptable.

As regards the request for exemption GST on the services of Haj and Umrah tour provided by Haj Group Operators [Private Tour Operators], the same has no merit. The private tour operators supply such services on purely commercial basis to pilgrims who can afford it. GST is an indirect tax. The burden of the tax is not on the suppliers but on the recipients. The service was taxable in Service Tax also. There is no justification for granting a new exemption. Exemptions not only cause loss of revenue but also block input tax credit chain and credit distortions.

Annexure- II

Subject: To provide level playing field to domestic MROs vis-à-vis foreign MROs by reducing GST on MRO services to 5% with full ITC and change PoS for B2B MRO Services to Location of Recipient.

Issue: Domestic aircraft maintenance repair and overhaul (MRO) industry faces comparative disadvantage vis-à-vis foreign MRO as explained below:

(i) Services provided by MRO in DTA –

The place of supply of MRO services is the location where the services are actually performed and not the location of the recipient of services, which is the general rule. As a result, services provided by Indian MRO units including SEZ units to the domestic airlines attract GST @ 18%. On the other hand, MRO services procured by the Indian airlines companies from the foreign MROs do not attract any GST. The only protection available to Indian MROs is the IGST payable u/S 3(7) of the Customs Tariff Act on aircraft/ aircraft engines sent abroad for repairs and re-imported into India after repairs on the value of repairs, freight and insurance both ways at the rate applicable on aircraft and aircraft parts which is 5% in most of the cases.

(ii) MRO services provided by Indian MROs to foreign airlines and aircraft leasing companies located outside India

A carve out has been made in the place of supply provisions, which provides that PoS of goods which are temporarily imported into India for repairs and exported after such repairs without being put to any use in India, shall be the place of location of recipient. [Identical provision existed in service tax]. MRO services provided by Indian MRO units including SEZ units to foreign aircraft leasing companies in respect of aircrafts leased to Indian airline companies are not covered by this carve out in PoS provisions. The aircrafts leased by foreign leasing companies to Indian airline companies are already in the taxable territory of India. They are not imported into India for repairs; nor are they exported out of India after repairs. The PoS of MRO services provided in respect of such aircraft is in India. Therefore, such services, even though they are supplied to the foreign leasing company and paid for in foreign exchange, are not treated as export of services and attract GST of 18%.
The MRO services provided by Indian MRO units including SEZ units to foreign airlines which operate routine flights to India are also not covered by the said carve out in PoS. The aircrafts of such foreign airlines come with passengers and depart after repairs with passengers. Such aircrafts which come on routine flights cannot be said to have been temporarily imported into India for repairs. They also cannot be said to have not been put in use in India after repairs as they carry passengers after such repairs.

(iii) MRO services sub contracted by the foreign MROs to Indian MROs

The Indian airline companies enter into annual MRO contracts with foreign MROs. The foreign MROs sub contract part of their services to Indian MROs. Though such services are provided to MROs located outside and payment is received in foreign exchange, they are not considered as export of services again because of the PoS provisions. Such services attract GST @ 18%.

2. **The present tax structure of MRO service** can be depicted as below:

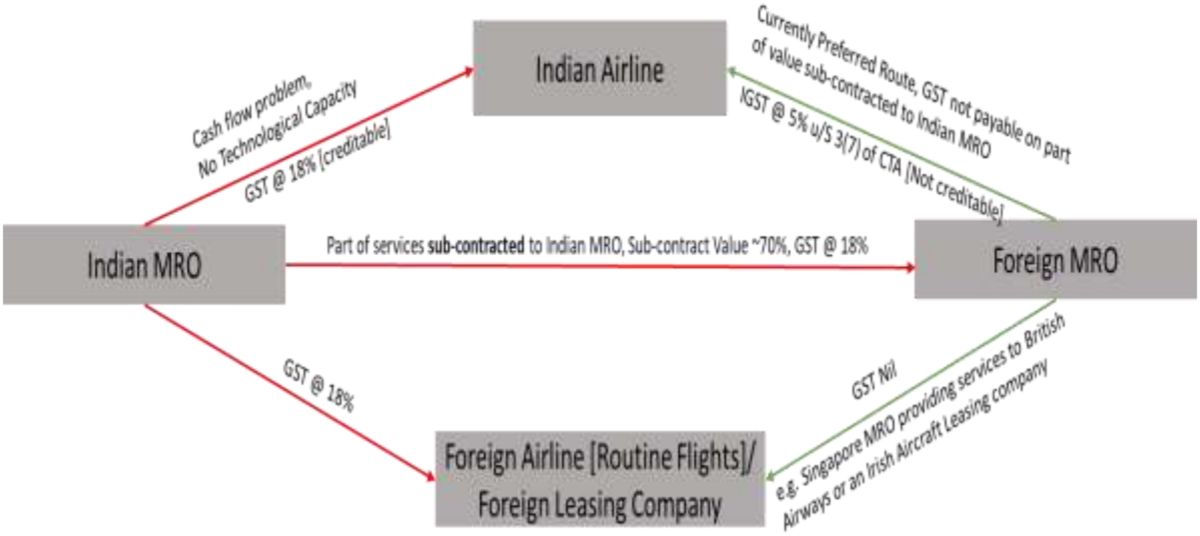


Figure 1: Present tax structure of MRO services

3. **Present status of MRO Industry in India**

At present, less than 2% of MRO service on aircrafts of Indian airlines is being performed by domestic MRO as shown below:

Table 1: MRO services availed from foreign MRO vs Indian MRO in FY 2018-19 (All values in INR Crores)

Airline	Value of MRO Services procured by Indian airlines		% of MRO Services procured by Indian airlines from Indian MRO
	from foreign MRO	from Indian MRO	
Air Asia	19	14	43%
IndiGo	2210*	47	1%
SpiceJet	1528	38	2%
Blue Dart Aviation	168	0	0%
Total	**5757**	**100**	**2%**

* As per annual report of Indigo. Source: MoCA

4. **<u>Proposal:</u>**

The following solution has been proposed to solve the above issues:

i. Reduce GST rate on MRO services to 5% with full ITC
ii. Change PoS for B2B MRO Services to Location of Recipient [Notification u/S 13(13) of the IGST Act]

Advantages –

1. Services of both domestic and foreign MRO will be taxed at the same GST rate of 5%
2. Domestic MRO will get additional protection as tax paid on goods sent abroad for repairs u/S 3(7) of the CTA will not be creditable
3. Reduced additional cash flow burden on airlines

Disadvantages –

1. The domestic airlines may object to this proposal on the grounds of additional cash flow burden.
2. GST rate of 5% may cause inversion of duty structure for MRO since some spares/ parts required in MRO are taxable at more than 5%

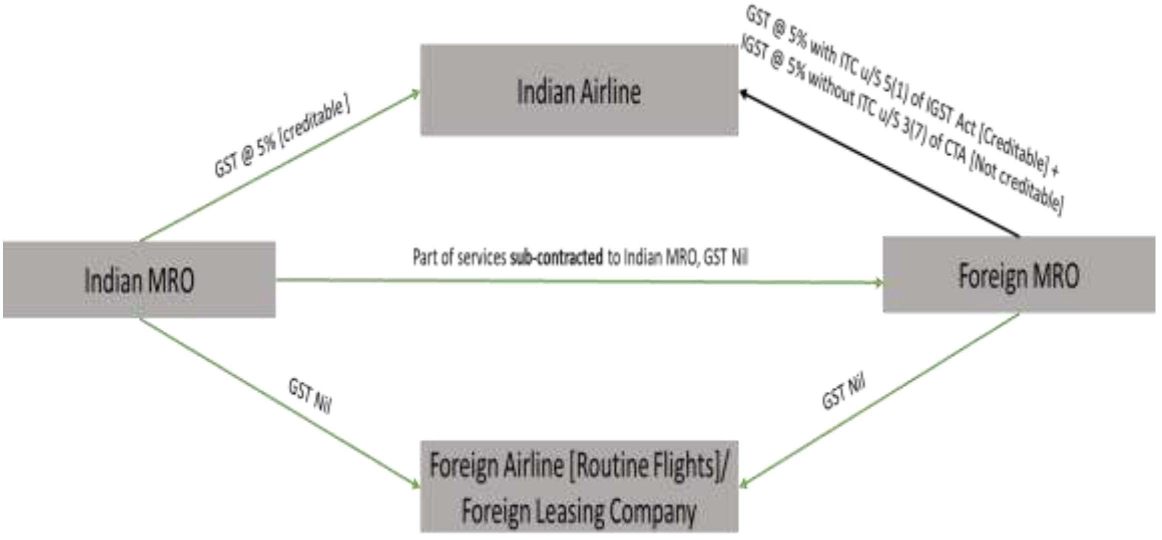


Figure 2: Proposed tax structure of MRO services

Comments of Maharashtra on the proposal:

Post circulation of the record of discussion in the Fitment Committee meeting, State of Maharashtra has conveyed comments on the proposal as under.

"So far as level playing field to domestic MROs and Indian shipping lines is concerned, we are trying to shift place of supply to outside India. However in both the cases POS change would result in Indian operators getting qualified for export (and in one contingency of MRO result in inversion). We do not have an idea of what their quantum of refund would be. However, on one side we are trying to reduce refund or do away inversion in cases of common utility items and on the other hand, here we may look like providing an advantage or favouring a particular industry. This is from public perspective, sir. This proposal will have to be justified on the basis of quantum of refund."

Annexure- III

Subject: To provide level playing field to Indian Shipping lines in light of the order dated 23.1.2020 of the High Court of Gujarat in the case of M/s. of Mohit Minerals Pvt. Ltd by changing the PoS of goods transport service from the place of destination of goods to the location of recipient.

<u>Background</u>:

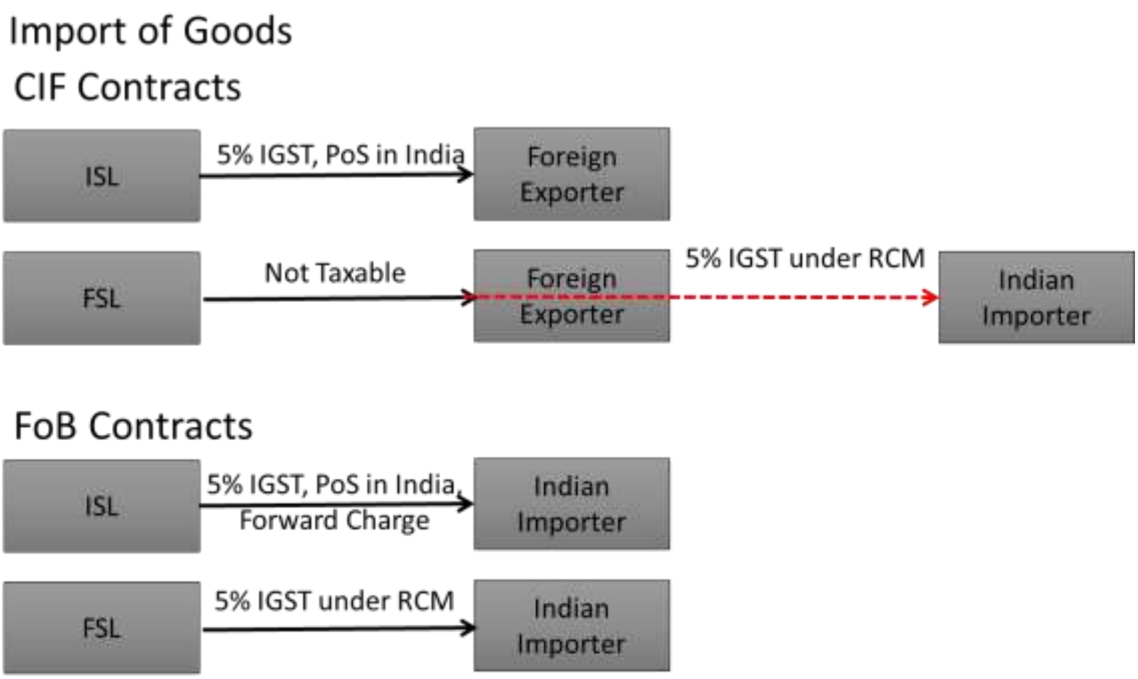
Prior to 1.6.2016 (Budget 2016-17), services by way of transportation of goods by an aircraft or a vessel from a place outside India upto the customs station of clearance in India were nontaxable by virtue of being in the negative list of services [66(p)(ii)]. Export freight was not taxable since place of provision of service was outside the taxable territory of India. [POPS Rules, Rule 10]. Thus, the Indian Shipping Lines (ISL) were unable to avail input tax credit of tax paid on input goods and services. Such tax formed a part of their cost and rendered them uncompetitive vis-a-vis foreign shipping lines (FSL).

1.2 Ministry of Shipping vide letter dated 8.12.2016 had requested that either the international import and export freight may be zero rated in line with international practice, or if this is not acceptable, then, inward freight may be taxed and ITC may be allowed against non-taxable export freight. In view of the requests of the Indian Shipping Industry and other stakeholders supported by Ministry of Shipping, in order to provide level playing field to Indian shipping lines vis-a-vis foreign shipping lines, service of inward transportation of goods by a vessel was made taxable to enable Indian shipping lines to use ITC available with them against export freight. This was done in consultation with Ministry of Shipping. It was expected that while Indian Shipping lines would pay service tax on import freight through ITC, foreign shipping lines would have to pay in cash.

1.3 Subsequently, many representations were received that in order to avoid payment of service tax on inward transport, FOB contracts were being converted to CIF contracts. This was possible because services received from a provider of service located in a non- taxable territory by a person located in a non-taxable territory were exempt from service tax vide entry 34(c) of notification No. 25/2012-ST. This defeated the purpose of the amendments effected in Budget 2016-17. In order that tax is suffered by both Indian shipping lines and foreign shipping lines on inward transportation of goods, service tax exemption was withdrawn for services 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 vide notification No. 1/2017-ST. Liability to pay service tax on such import freight was placed on importer under RCM. Similar dispensation continues in GST.

2. **Present Tax structure for Ocean Freight**

The present tax structure of Ocean Freight can be depicted as below:



3. **Judgment of High Court of Gujarat in the case of M/s. of Mohit Minerals Pvt. Ltd**

In the order dated 23.1.2020 of the High Court of Gujarat in the case of M/s. of Mohit Minerals Pvt. Ltd. it has been held that Notification No. 8/2017 – Integrated Tax (Rate) dated 28th June 2017 and the Entry 10 of the Notification No.10/2017 – Integrated Tax (Rate) dated 28th June 2017 which require the importer to pay IGST on ocean freight in respect to CIF consignment under RCM are ultra vires the law. The High Court has given the judgment on the following grounds:

a) The charging section provides for payment of GST by person who is making supplies and in certain notified cases, by the recipient of supply. Thus, GST is not payable by a person who is neither a supplier nor a recipient. The provisions of section 5(3) of IGST Act does not provide for fixing the liability on any person other than the recipient.

b) Importer has neither availed the ocean freight service nor is he liable to pay the consideration. Hence, he is not the recipient. If the importer is held to be recipient of supply of ocean freight service, then he shall also be the recipient of various other inward supply of goods and services received by the exporter of goods with regard to said imported goods. Importer can't be made to pay tax on the supposed theory that he is directly or indirectly recipient of the service. Such interpretation is unwarranted.

c) Tax can be levied only on intra-State supplies and inter-State supplies. Provision of ocean freight service by a non-resident person to another non-resident person is neither an intra-State supply nor an inter-State supply. Therefore, notification entries taxing the said service are beyond the scope of the Act.

4. Analysis of the judgment:

4.1 The judgment is based on sound legal reasoning. It will be difficult to succeed in appeal against the same in Hon'ble Supreme Court and succeed in appeal.

4.2 The immediate consequence of this judgment is that the level playing field, which was given to Indian Shipping Lines by making importer liable to pay GST on ocean freight charged by foreign shipping lines from foreign exporter under RCM, is no longer available to Indian Shipping lines. Therefore, there is a need to find out a way to continue to provide level playing field to Indian Shipping lines despite the judgment. The issue has been examined with this view in the following paragraphs.

5. International Practice

Globally, major maritime jurisdictions have a zero-rated tax treatment for import cargo as well as export cargo transportation services. In addition to zero rating the inbound ocean freight, many countries like Canada, Singapore and Australia have zero rated local handling/ transportation and other ancillary services which are provided as a part of continuous inbound ocean freight services. Relevant extracts of the respective jurisdictions regarding freight transport are reproduced below for reference:

5.1 **UK:** To determine the VAT treatment of freight transport and related services, all of the following points are to be considered in order: the status of your customer: Whether 'in business' or not, the place of supply of services, and the liability of the supply. Freight transport and related services fall under the 'general rule' when supplied to customers 'in business'. The general rule is that the place of supply of services to a person who's 'in business' is the place where the customer belongs for the purposes of receiving your supply. The place of supply of these services that would have a place of supply in the UK under the general rule, but which take place wholly outside the EU, is treated as taking place where performed. **If the place of supply of freight transport or related services is the UK, t**he supply is standard rated, **except for**, *inter-alia,* the supply of transport or related services connected with an import to/ export from the EU or when the supply is zero-rated.

5.2 **Australia:** Subdivision 38-K (Transport and related matters) of Division 38 (GST-free supplies) of Part 3-1 (Supplies that are not taxable supplies) of Chapter 3 (Exemptions) of the GST Act of Australia states that the international transport of goods is GST free, i.e. zero rated.

5.3 **Singapore:** Section 21(1) of the Singapore GST Act zero rates international services and Section 21(3)(a)(ii) *ibid.* includes international transport by Sea in the definition of international services.

5.4 **Canada**: A supply of a freight transportation service in respect of tangible personal property from a place in Canada to a place outside Canada is zero-rated under section 6 of Part VII of Schedule VI where the value of the consideration for the supply is $5 or more.

6. Proposal:

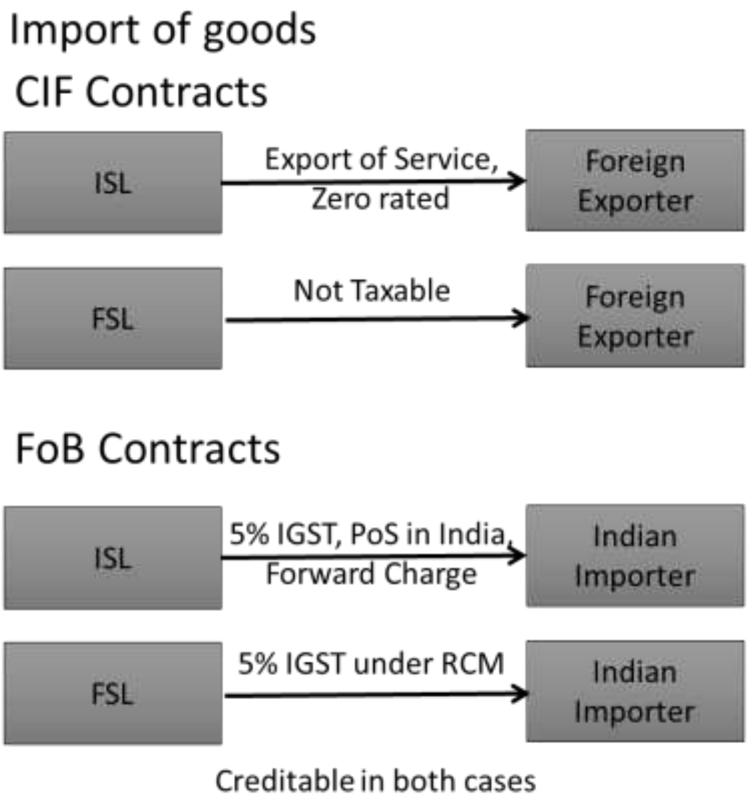
The objective of providing level playing field to Indian Shipping Lines can be achieved by changing the place of supply of goods transport service from the place of destination of goods to the location of recipient. This would ensure that both Indian Shipping Lines and Foreign Shipping Lines have identical liability to pay or not pay IGST on transportation of goods by vessel (inward, outward or coastal) in both CIF and FOB contracts. A tabular representation of taxability of the said service with the proposed PoS is as under:

Contract	Supplier	Recipient	PoS	Tax Liability	Liability on
Import Ocean Freight					
FoB	ISL	Indian Importer	India	Taxable with ITC available to importer	ISL
FoB	FSL	Indian Importer	India	Taxable under RCM with ITC available to importer	Indian Importer
CIF	ISL	Overseas Exporter	Outside India	Zero rated (Export of service)	ISL
CIF	FSL	Overseas Exporter	Outside India	Outside GST (Neither inter-State nor intra-State supply)	NA
Export Ocean Freight					
FoB	ISL	Overseas Importer	Outside India	Zero rated (Export of service)	ISL
FoB	FSL	Overseas Importer	Outside India	Outside GST (Neither inter-State nor intra-State supply)	NA
CIF	ISL	Indian Exporter	India	Taxable with ITC available to exporter (currently exempt upto 30.9.2020)	ISL
CIF	FSL	Indian Exporter	India	Taxable with ITC available to exporter (currently exempt upto 30.9.2020)	Indian Exporter

Note: - ISL – Indian Shipping Line, FSL – Foreign Shipping Line

6.1 International VAT/GST Guidelines by OECD also state that the general rules on place of taxation for business-to-business supplies will lead to an appropriate result when considered against the criteria set out in Guideline 3.7 (Neutrality, Efficiency of compliance and administration, Certainty and simplicity, Effectiveness and Fairness) in most circumstances.

Proposed Tax structure for Ocean Freight




Export of goods
CIF Contracts
ISL
5% IGST, Exempt till 30.09.2020 with ITC
Indian Exporter
FSL
5% IGST under RCM, Exempt till 30.09.2020
Indian Exporter
FoB Contracts
ISL
Export of Service, Zero Rated
Foreign Importer
FSL
Not Taxable
Foreign Importer

Annexure- IV

Subject: Proposal to tax job work service in relation to manufacture of alcoholic liquor for human consumption @ 18%– reg.

Law Committee, in its meeting dated 28.01.2020 has recommended to issue a clarification that in an arrangement where a contract manufacturing unit i.e. TMU/CBU undertakes to manufacture alcoholic liquor for human consumption for and on behalf of brand owner (BO), and receives consideration in the form of bottling charges, conversion charges or in any other name or form, such consideration is taxable. It is also proposed to clarify that the said service supplied by CBU/ TMU to BO shall be classified as 'manufacturing services on physical inputs (goods) owned by others' under heading 9988 of scheme of classification of services annexed to the notification No. 11/ 2017- Central Tax (Rate) dated 28.06.2017 which currently attracts GST rate of 18% under Sl. No. 26(iv) of the said notification.

2. Reason why manufacture of alcoholic liquor by a contract manufacturer for the brand owner will not be eligible for GST of 12% prescribed for 'job work' under entry 9988, Sl. No. 26(id) of notification No. 11/ 2017- CTR is that, an activity qualifies as job work only if it is carried out on goods belonging to a registered person. Alcoholic liquor is outside GST and therefore brand owner is not required to take registration under GST. However, brand owner may take registration for selling mineral water and carbonated water etc. and avail lower rate of GST of 12% as applicable to job work.

3 The rate of GST on job work was reduced to 12% mainly on the ground that ITC of the same is available to the principal manufacture and reduction is GST would not affect revenue. In sectors, where the principal supplier is not eligible for ITC, there is no justification for reduced rate of 12% on job work.

4 It has been ascertained that GST @ 18% is being paid in most cases. However, in isolated cases TMUs are claiming alcoholic liquor as food products and paying GST @ 5% as applicable on job work service in relation to food and food products falling under chapters 1 to 22 in the First Schedule to the Customs Tariff Act, 1975 (sl. No. 26 (i)(f) of the notification No. 11/2017- CTR refers) being alcoholic beverage as food products. It has been stated that definition of 'food' under section 3 (j) of the Food Safety and Standards Act, 2006 covers alcoholic drinks.

Proposal:

5. Therefore, to avoid dispute and litigation it is proposed that,-

(a) services by way of job work in relation to manufacture of alcoholic liquor for human consumption may be excluded from the residual entry for job work service at 9988 (id) prescribing 12% rate of GST and taxed at 18% as has been done in case of job work related to bus body building.

(b) An explanation may be inserted at entry 9988 (i)(f) of the notification no 11/ 2017- CTR which prescribes GST rate of 5% for job work services in relation to food and food products to the effect that " for removal of doubts it is clarified that food and food products excludes alcoholic beverages for human consumption".

Comments of Tamil Nadu and Maharashtra on the proposal:

Post circulation of the record of discussion in the Fitment Committee meeting, State of Tamil Nadu and Maharashtra have conveyed comments on the proposal as under.

<u>Tamil Nadu:</u>

"…… Alcoholic beverages are treated as food products as per the definition of 'food' under section 3 (j) of the Food Safety and Standards Act, 2006 it goes without any dispute that alcoholic drinks are only food products.

As per Notification No. 11/2017 – Central Tax (Rate) as amended by Notification No.31/2017-Central Tax (Rate), dated 13th October, 2017 at serial No. 26(i)(f), " the job work services in relation to manufacture all food and food products" falling under Chapters 1 to 22 in the First Schedule to the Customs Tariff Act, 1975 (51 of 1975) is taxable at 5%(2.5% SGST and 2.5% CGST). This is specific entry available in the above said Notification.

Accordingly as per the specific entry available as above, the job work services in relation to manufacture of alcoholic liquor for human consumption is to be assessed at 5% under GST. Currently job work of alcoholic liquor for human consumption are being levied GST at 5% only. They cannot be compared with bus body building, where the nature of job work and the product manufactured is totally different.

Increasing tax rates to 18 percent will adversely affect the interests of State revenues in a different manner. States have the domain over the above goods for taxation and the States have flexibility in altering the rate of tax on the sale of Alcoholic Liquor for Human Consumption and few more goods only. The proposed change will affect the ability of the States to alter tax rates on alcohol for human consumption and reduce their fiscal manoeuver ability.

Any increase in tax in the manufacturing process of alcoholic liquor will result in demand from manufacturers for increasing the MRP as these taxes get embedded in the costs and increase their cost of production. As it is, State Government has been taxing alcohol at high rates. The proposed increase will therefore result in demand for corresponding reduction of State Tax on alcohol or increase in MRP both of which are undesirable from States' point of view……"

<u>Maharashtra:</u>

"So far as the rate of tax on Job Work in relation to manufacture of alcoholic liquor for human consumption is concerned, Maharashtra agrees with the views expressed by Tamil Nadu to the extent that rate of tax may be considered at 5% instead of 18% for the reason that flexibility for upward revision in State Excise Duty is available to the state."