



## Implementation of GST, a major milestone in financial services sector

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### Abstract

India finally seems to be on the cusp of implementing the much-awaited tax reform of Goods and Services Tax (GST). With the release of the Model GST Law on 14 June 2016, we crossed a major milestone and have certainly moved a step closer to GST. It is noteworthy that the Model GST Law has been released on the final day of meeting of the Empowered Committee of the State Finance Ministers and reflects a determined intent on the part of the Government to pass the Constitution (122nd Amendment) Bill in the forthcoming monsoon session of the Parliament. Globally the trend for the Financial Services (FS) sector has been either complete exemption or partially subject to GST. In jurisdictions where it is partially taxed, the approach has largely been to tax Fee-based activities with restricted input tax credits, while keeping the Fund based-activities outside the tax net. In the GST regime, the FS sector is expecting the partial basis of taxation, as prevailing in the present regime, to continue, with clarity on place of supply of services and seamless credits across the country. GST for the FS sector would be a major transformation as it would have an impact on the financial products, the IT system, processes and a shift from centralized compliance to State-wise compliance. The industry would need to analyze the provisions of the Model GST Law and its impact on their business. This is essential to ensure that timely representations are made to the Government, and to identify implementation requirements for smooth transition to GST regime. In the ensuing paragraphs, I have sought to identify the key aspects of the Model GST Law as may be relevant for the FS sector.

**Keywords:** financial services, model GST law, state-wise compliance, issues in the current regime, smooth transition

### Introduction

The financial services industry must be spared a compliance nightmare when the goods and services tax (GST) is rolled out. The industry is happy to pay whatever tax is due but would like the Centre and the states to sort out how to share the proceeds amongst themselves without making service providers jump through hoops to facilitate that division. Most financial services span multiple states and extensively use computer networks and servers, whose location at a particular site has no real bearing on where, and from where, a service using those networks is rendered. The sensible thing to do would be to treat all financial services as inter-state transactions to be taxed under Integrated GST, with all

vendors to financial services also being taxed under IGST, so as to avoid accumulation of input tax credits that cannot be availed of.

The GST Council must see reason on the matter. The model law also proposes to tax intra-firm supplies of services without any payment attached to the service. The tax on intra-firm cross-border supply of services will lead to complex valuation challenges and possible transfer pricing disputes, and prove a compliance nightmare that yields little tax. It should be scrapped. The limited time available to configure complex IT systems to comply with the tax is the other challenge. Australia gave companies a clear 12 months to comply with the tax after the rules were finalized and made public.

### Classification of Financial Services (Fig-1)

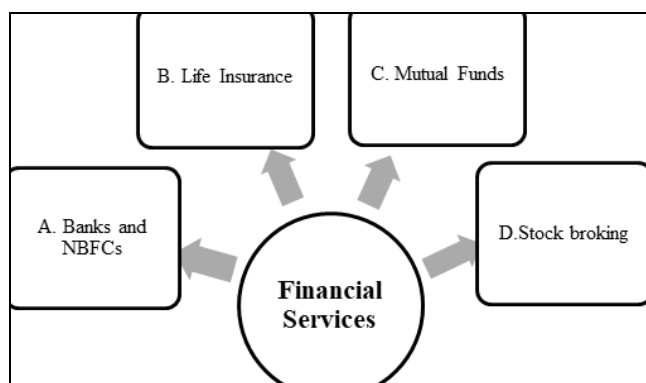


Fig 1: Financial Services.

## A. Banks and NBFCs

- 1) **Place of supply of FS Products:** Presently, the place of provision of services provided by Banks/ NBFCs to account holders is the location of the service provider. Thus, notwithstanding the fact that the customer may be outside India, service tax is payable. The Model GST Law specifies the place of supply of services for banking and other financial services (BOFS) as: in cases where the services are linked to the account of the receiver, the location of the service receiver on the records of the service provider; and where the service is not linked to the account of the receiver, the location of the service provider. Under the present regime, where there is a concept of 'intermediary services'; the Model GST Law does not provide anything specific under the Place of Supply provisions. Hence, if Banks/ NBFC's are providing cross-border intermediary services, e.g. branch of a foreign bank providing intermediary services for trade finance transactions, the place of supply could be outside India.  
The following issues arise, on which clarifications should be sought from the Government: Determining 'location of service recipient' in the digital world, where banks are now endorsing anywhere or everywhere banking concept; The terms, 'banking and other financial services' and 'account' are not defined. Hence, it is not clear which activities would be covered under this rule; whether permanent or communication address would be considered to determine the location of service recipient; and determining place of supply for B2B Customers with multiple offices.
- 2) **Interest Income:** Presently, services provided by way of extending deposits, loans or advances, where consideration is represented by way of interest or discount, is covered by the negative list of services. Thus, such income is not subject to service tax. The Model GST Law does not specifically exclude applicability of GST on income by way of interest or discount. However, it is expected that such income by way of interest and discount would continue to be non-taxable, and it will be covered by the negative list of supplies.
- 3) **Free supply of services:** Presently, as per the definition of the term, 'service', only those activities which have a consideration are liable to service tax. However, the Model GST Law also proposes to tax services by a taxable person to another person in the course of furtherance of business, without any consideration. This proposal could have far reaching implications, as identification and value attribution for such supplies could be challenging. For example, customers maintaining minimum account balance are eligible for certain benefits and such free services could be subject to GST. Hence, the industry should represent that the instances of free supply of services should be specified in the GST legislation.
- 4) **Sale of securities:** Presently, under the State VAT laws, the definition of the term, 'goods' specifically excludes securities. Hence, VAT is not payable on sale of securities. Under the Model GST Law, the term, 'goods' includes securities. However, it is expected that such a

transaction would be covered by the negative list of supplies.

- 5) **Securitization transactions:** Presently, the definition of the term, 'service' specifically excludes actionable claim, whereas under the Model GST Law, the term, 'service' specifically includes actionable claim. The BOFS sector is facing significant NPA challenges, and securitization is critical to address the NPA issue. It seems that by including actionable claim, transactions such as securitization could be subjected to GST. However, it is possible that securitization could get covered in the negative list.
- 6) **Finance Lease:** Presently, finance lease transactions are liable to both, VAT and Service Tax, and ordinarily operating lease transactions attract VAT. Further, VAT is not payable on import of assets on lease basis. Under the Model GST Law, a finance lease would be considered as supply of goods, and an operating lease would be considered as a service. Further, leasing of an asset from outside India will be liable to IGST.
- 7) **Sale of Repossessed Assets under the VAT laws:** Taxability of sale of repossessed assets in the hands of Banks/ NBFCs has been a contentious matter. Various courts have confirmed the applicability of VAT on Banks/ NBFCs and the matter is now pending before the Supreme Court. In the Model GST Law, if Banks/ NBFCs are treated as suppliers of such assets, the overall cost of operations for Banks/ NBFC's would go up, as it is expected that the rate of GST would be higher than the present VAT rate.
- 8) **Input tax credit – proportionate vis-à-vis fixed reversal ratio:** Presently, as per CENVAT Credit Rules, Banks/ NBFCs have options to reverse CENVAT credit either to the extent of 50%, or on proportionate basis to the extent of exempt turnover. Under the Model GST Law, there is no such provision for availment of 50% credit. If such option is not available, then Banks/ NBFCs would be required to reverse input tax credit to the extent attributable to non-taxable supplies. Proportionate basis of reversal has scope for alternative interpretations and/ or verification from authorities. Hence, it should be represented that the option of reversal on the basis of a fixed ratio should also be available.

### Key action points

Determine the GST impact for financial products and identify options to restructure the financial products

- Analyze the impact on transaction systems and financial systems.
- Address of account holders should be mapped in the transaction systems.
- Review the procurement policy to ensure optimum credit eligibility.

### Key Points for Representation

- Clarify the scope of BOFS, location of service recipient, and the term, 'account'.
- Clarify the scope of free supplies in the context of BOFS
- Interest and discount should be notified as an income not liable to GST

- Transactions in securities and securitization should not be liable to GST
- Option to reverse ad hoc 50% input tax credit

### **B. Life Insurance**

**Taxability of life insurance services:** Under the present regime, non-linked endowment insurance products are taxed at a lower service tax rate. The Model GST Law does not have a specific provision for such products. Presently, the place of provision of services rendered by a life insurance company is determined on the basis of the location of the policy holder. Under the Model GST Law, the place of supply for life insurance services.

### **C. Mutual Funds**

**Services provided by mutual fund agents/distributors:** Presently, service tax is applicable on management fees charged to Mutual Fund (MF). Further, the asset management company (AMC) has centralized registration, and it avails credit of expenses incurred by branches all over the country, at its principal place of business.

Under the Model GST Law, there is no specific place of supply rule for the operations of the MF and the AMC. Hence, the supplies of MF and AMC shall be governed by the default rule, i.e. the place of supply would be the location of the service receiver. Since under GST, there would be State-wise registrations, AMCs need to review their procurement models to ensure that there is no blockage of credit. Additionally, the Model GST Law allows transfer of accumulated input tax credit by way of input service distributor (ISD) mechanism.

### **D. Stock broking**

**Place of supply of stock broking services:** Under the present regime, stock broking services qualify as an 'intermediary' and accordingly, the place of provision of service is the location of the service provider. Hence, in case of FIIs/ FPIs, irrespective of where the customers are located, the place of provision of service is in India and liable to service tax. The Model GST Law specifies the place of supply of services in case of stock broking services as: in cases where the services are linked to the account of the receiver, the location of the service receiver on record of the service provider; and where the service is not linked to the account of the receiver, the location of the service provider.

### **E. Other common points**

1. **Coverage:** Presently, service tax law extends to whole of India excluding the State of Jammu and Kashmir (J&K). However, the Model GST Law does not have any specific exclusion for J&K. Hence, it seems the operations in J&K would be subject to GST.
2. **Input tax credit scope:** The definition of capital goods has been drafted on the same lines as in the existing CENVAT Credit Rules. Accordingly, input tax credit will be allowed only on those goods falling within the specified Chapters of the Model GST Law. Further, the definition of inputs and input services also provides for exclusions. If the mismatch is not rectified by the vendor in the month of communication, the recipient will be liable to pay the differential GST along with interest in

the subsequent month. This provision places the liability for non-compliance on the recipients. Similar provisions have been prescribed wherein details of credit notes issued by a supplier have to match with the corresponding reduction of input tax credit claimed by the recipient. Accordingly, if a B2B customer does not adjust the input tax credit, the tax and interest would be recovered from the service provider.

3. **Place of supply of services provided to or received at multiple locations:** The definitions of 'location of supplier' and 'location of recipient provides' that the establishment most directly concerned with supply shall be considered. A company may receive a service in multiple establishments located in different states. In such situations, the Place of Supply provisions are unclear as to which establishment would be regarded as the location of service provider/receiver, in order to determine whether the supply is an intra-State or inter-State supply.
4. **Point of taxation:** The point of taxation for supply of services, among other criteria, includes the date on which the recipient shows receipt in his books of accounts. This date would be impossible to track on an ongoing basis. Further, under the Model GST Law for reverse charge, among other criteria, the date of receipt of goods or services or the date of receipt of invoice is the point of taxation, whichever is earlier. It would be cumbersome to track these two dates.
5. **Valuation of service in case of related persons:** Under the GST Model Law, the concept of valuation for services in related party transactions has been introduced. Therefore, for any services provided between group companies, such as back office support services, cross-charge for common expenses, etc., it needs to be demonstrated that the transaction is at arm's length. If this cannot be demonstrated, the value will be determined based on the GST Valuation Rules, i.e. based on services of like kind and quality or the cost of providing the services, including profit.
6. **Input service distributor:** The Model GST Law provides for the distribution of IGST/ CGST/ SGST. This is a welcome measure. The distribution of SGST as IGST needs to be clarified, as the GST framework does not contemplate utilization of SGST of one state against SGST of another state.

### **Conclusion**

To conclude, introduction of Model GST Law is a significant development. However, substantial work still needs to be done on the law as well as on the IT framework. Further, business needs to represent to the Government/ Empowered Committee to obtain clarifications/ reliefs and commence planning for GST transition.

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