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Banking sector in India; a more focused area under GST

Dr. Jayashree, R Kotnal
Assistant Professor & Head, BLDEA's SBS Arts & Commerce College for Women, Vijayapur, Karnataka, India

Abstract
The introduction of GST in India is a substantial shift from the current tax regime. It is expected that service sectors will have major impact of GST than the manufacturing or trading sector. Among the services provided by Banks and NBFCs, financial services such as fund based, fee-based and insurance services will see major shifts from the current scenario. Owing to the nature and volume of operations provided by banks and NBFC vis-a-vis lease transactions, hire purchase, related to actionable claims, fund and non-fund based services etc., GST compliance will be quite difficult to implement in these sectors. Under Model GST Law, the framework does not provide much benefits or consideration to banks and NBFCs on understanding of the type of transactions made by them on a consistent and voluminous basis. Some of the issues and impacts pertaining to the provisions in the Model GST Law have been discussed in this paper**.**

Keywords: NBFCs, banking sector, IGST, SGST/CGST, impact

Introduction

Banks and financial services companies will face challenges under the GST because of changes to the place of supply rules under the GST. Section 10 of the Model GST Law creates distinct taxable persons for each registration in each state, these institutions will file more tax returns under this rule because branches in each state will need to file GST returns as opposed to a consolidation at the national level. A consequence of this change is a requirement for banks to examine their different source systems and make sure these systems can apply GST to the relevant transactions, apply the correct tax regime (IGST, SGST/CGST) and then classify transactions correctly. Even after the upstream classification and rate selection is done, there is still the matter of quickly and correctly completing several GST returns for a single institution.

When there are a variety of different systems make decisions regarding the application of tax this creates a point where an institution must choose between business as usual which is to build, test, and maintain all tax relevant data in multiple locations or consider an alternate solution. Further complicating the design and build scenario is the requirement to factor in the elements of:

- Intra-state
- Interstate
- International

These were previously not aconsider under the old regime which was focused on taxation in the place of the provision of the service. For example, the model law has bifurcated the place of supply rules for financial services between:

- Supplier and Recipient are in India.
- Either the Supplier or Recipient are not in India.

Under the first scenario, the place of supply will be the location of the recipient on the supplier's records; in the second scenario, the place of supply will be the location of the supplier.

A financial institution will have need to bring the following pieces of information together to make the decision regarding the tax treatment for a transaction:

- Supplier Location – Branch – including state
- Recipient Location – including state
- Type of Supply

If a non-resident receives services from a branch in Mumbai, then the supply is subject to IGST at a rate for the supply and the place of supply is Maharashtra. Contrast this with a situation where the supply is made to an Indian resident with a normal address of Gujarat then the supply is IGST at the rate for the supply but the place of supply will be Gujarat. In the first case, the supply will be reported most likely as an export of services and in the second case, the supply could be reported as either a B2B or B2C transaction. This is a complex set of decisions which financial institutions must ensure are made daily on a consistent and accurate basis.

Now, the model law still has not specified how financial and insurance transactions will be taxed and what rates will apply. It is expected that the general global rules will continue to be applied which will be to tax situations where fees are levied and transactions which are interest based will be exempt.

Table 1: Taxable and Exemption Transaction.

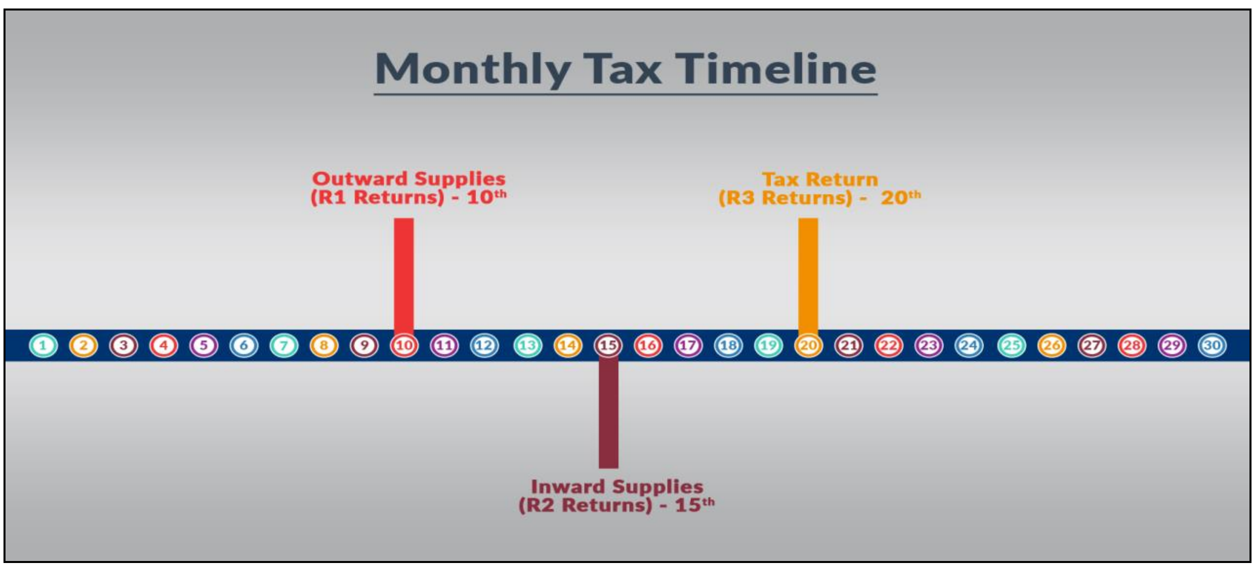
Taxable Transactions	Exempt Transactions
Loan Processing	Provision of loans
Counting	Advances
Rental Services	Currency
	Travelers Checks

***Source*:** https://cleartax.in › ... › Impact of GST on Banks and NBFCs.

Section 17 of the Model Law imposes further restrictions on banks because the institution must choose between the attribution method or a monthly allowance of 50% of input tax credits. Under the direct attribution method, input tax credits can only be applied to taxable supplies and zero-rated supplies and not exempt supplies. Combine this with the requirement for distinct taxable person in Section 10 and a bank at a national level has a challenge in determining the possible input tax credit they can claim monthly. While most businesses claim input tax credits for most items except for restrictions found in Section 17(4) or created under Section 17(5) a bank must make sure it tracks the taxable and zero-rated supplies monthly to determine the maximum input tax credit possible.

After the institution, has set up all the upstream process to ensure it can have the relevant data for compliance it needs to now decide how to tackle the problem of compliance. Now he institution creates returns on a state by state basis but at the same time it manages workflow associated with creating all of these returns. The previous compliance process for a bank was to complete a Service Tax return which could be consolidated at the national level for all the different locations in a single return.

Table 2: Monthly Tax Timeline.



***Source*:** https://cleartax.in › ... › Impact of GST on Banks and NBFCs.

A large organization for GST compliance could continue to use its present approach which is to consolidate data and attempt to make filings and then make changes but with the requirement to upload data to the GSTN and creating headaches for customers there could be a more efficient approach for a large institution.

Using a commercial solution for GST compliance, saves time and money in development and maintenance costs and it depending on the financial institutions information security policies it could further gain from having the solution hosted on a public cloud. Multitenancy combined with roles and workflow allows the data for several locations to be segregated but the bank can allow internal tax teams or tax partners to work on multiple sets of data without having to spend time with separate accounts, systems and logins. Another efficiency gain is to have a system which allows for scheduled data transformation and upload.

enComply offers the ability to have a tax engine to ensure the decisions are made in a consistent basis for the upstream processing with a variety of different source systems and a compliance offering which is a SaaS multitenant cloud which combines workflow and data transformation. This combination gives financial institutions the ability to be more efficient with the single biggest tax change in India's history.

Talks on "GST Implementation" began in India way back form year 2000 and post gestation for around 16 long years; finally the day of 8th August 2016 saw the birth of "Goods and Service Tax Bill". Among several initiatives which could spur up India's GDP, GST implementation alone brags for contributing 2% rise.

GST may come into expanding the cost of the saving money and budgetary administrations. An administration tax of 15% is demanded on money related administrations at present. With the accepted GST tax rate of 18% to 20%, one might say that administrations will get costly. Numerous compliance issues may likewise emerge with the use of GST while the banking sector suggests that GST must not cover monetary and manage an account administrations. One might say that collection of GST on banking and finance sector will be excessively testing. Subsequently, GST will emerge as transformative stride, changing the entire taxation arrangement of India.

Registration

As per Model GST Law, banks having branches in multiple States and Union Territories (UTs) will be required to register in each such State and UT.

Currently, banks follow the Zonal or Regional structure where for one large State, there may be more than one Zone and conversely, one Zone may comprise more than one State.

Accounts and Administration

- As GST stands today, transactions between two branches of same bank is set to trigger a tax, which could prove to be cumbersome.
- GST would require restructuring of accounting, administration and control mechanism in the IT systems and processes of banks to be able to maintain financial records of each State separately.
- GST being levied on branch transactions could be cumbersome because of the enormous number of financial transactions being carried out.

Services by bank

- Some services by bank to a customer are centralized (Ex: Demat Account, Wealth Management services, bigger home loans etc.) while some others are localized to branches (Ex: Savings account, Personal loan, OD etc.).
- Banks provide different types of services to customers like Debit Card, Credit Card, Internet banking, Cheque Clearance, NEFT, RTGS, IMPS, Funds Transfer, Demand Draft, Demat Account, Wealth Management services, home loans, Savings account, Personal loan, etc.
- Bank Head office also provides services to branches which may become taxable under GST. The IT systems of banks need to be upgraded to meet all these requirements related to multiple registrations, determining point of supply of services, compliance needs and Input Service distribution.
- Currently, the power to levy and collect Service Tax on all services is with the Centre. With the introduction of GST, the States would also be empowered to levy GST on services.
- Accordingly, on the same activity, there would be two levies, namely Central GST (CGST) and State GST (SGST), levied and administered by the Central Government and State Governments respectively. For interstate supply of
- Several activities of banks are currently exempt from service tax (Ex: Fund based activities like interest payable on deposits / savings bank accounts and loans disbursed) which would incur GST unless otherwise exclusively exempted.
- It will be impossible for banks and finance institutions to value services provided by one branch to another and then pay GST on that.

Place of Supply of Goods and Services

- In banking industry, it's interesting to know the place of business.
- Even though the person is having an account in a single location, he can do the transactions across globe through internet banking.
- The account holder can use his mobile or laptop and can do transactions from anywhere.
- A Customer having an account in Chennai may do the transaction from Delhi and can transfer money to persons from Kolkata having account in Mumbai. Here point of supply identification is very much required for taxation purpose under GST.
- As per law even though it can be tracked it will be cumbersome tasks and determining point of supply of services would add significantly to the compliance cost.
- Taking the example above, is it required to take the registration across India in each state and Union Territory to abide by the laws of each state and Union Territory.
- As per section 6(13), in the case of banking and other financial services (BOFS), the place of supply shall be the 'location of the recipient of service' on the records of supplier of services.

Under such circumstance determining point of supply at each stage is very cumbersome.

- In order to determine the GST, it would be necessary to determine the place of receipt of supply of service and place of supply of service.
- It is possible that actual recipient of such services may be different offices/ plants of the customer situated in different States and therefore, there could be a doubt as to whether each time, the bank would be required to capture the location of the recipient of service for each transaction.

Invoicing

Section 25 of the Model Law requires uploading of invoices on Goods and Services Tax Network (GSTN) by 10^{th} of the next month. It means wherever the recipient of service wants to avail input tax credit, each and every document, where under certain fee or commission or charges have been charged and on which GST is levied, is required to be uploaded electronically on the GSTN by the service provider. It is a fact that banks do not issue commercial invoices for every service rendered. It would practically be a very difficult task to issue invoices for such small amounts and uploading them on GSTN.

Repossession of assets of defaulters

As per existing law and practice, when a bank repossesses assets from a defaulter of loan and sells the same, VAT is paid by the bank as a 'dealer' in terms of State VAT laws. Treatment of this under GST will be quite interesting, which need to be looked upon.

Conclusion

With the expectation of further details to emerge, financial sectors face a can of worms in terms of the manner of transacting business, customer profiles, services matrix, IT systems and operation to capture the data at both front and back end. IT systems will need to be more vigilant in terms of serving the purpose of solving the complexity related to GST compliance and procedures at a higher volume.

The impact of GST on Banks and NBFCs will be such that operations, transactions, accounting and compliance will need to be reconsidered in its entirety.

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