

Decoding the draft GST law

Impact on IT/ ITES sector

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India on the brink of GST

The current Indirect tax regime in India provides for a complex tax environment due to multiplicity of taxes, elaborate compliance obligations and tax cascading. In addition, the IT/ ITES sector has been fraught with disputes due to ambiguity in provisions as well as multiple taxation (dual taxation).

Under the proposed GST regime all the key Indirect tax legislations would be subsumed and hence it is expected that it would result in a simpler tax regime especially for the IT/ ITES sector.

There has been significant progress on the GST front recently. With the release of the draft Model GST Law on 14 June 2016, a major milestone has been achieved, and we have certainly moved a step closer to GST. It is expected that the Government would push for passage of the GST Constitution Amendment Bill during the upcoming Monsoon session. India finally seems to be on the cusp of implementing this much-awaited tax regime.

In light of the above developments, industry would now need to analyse the provisions of the draft law in detail, its impact on their business. This is essential to ensure that timely representations are made to the Government, as well as to identify key implementation requirements as part of the preparations for transition from the existing indirect tax regime to GST regime.

In the ensuing paragraphs, we have sought to identify the key aspects of the Model GST Law as may be relevant for the IT/ ITES sector.

1. Compliance requirements to increase

Registration may be required in each State where there is a premises from where supplies are being made. Hence, companies may need to obtain registration in each State where there is a premises from which services are being provided. This will increase the compliance burden, as presently, companies are governed primarily by the Centre under service tax, where companies can obtain centralized registration; however under GST companies would need to obtain registration under CGST, SGST and IGST in each State where they have a place of business providing services.

Compliances could therefore move from a centralized system as at present, to a decentralized system, leading to multiplicity of returns, refunds, credit pools, etc. This would also require sufficient preparation from an IT systems perspective for the companies to manage these compliances.

Key Action points

- Identification of States where registration may be required
- Focus on re-organising the contract structure and billing structure.
- Appropriate changes required in IT systems to be GST compliance ready

2. Export of services

Exports are being zero rated, and therefore input taxes paid should be allowed as refund. However, to determine whether the services qualify as export, it would be important to analyse the conditions prescribed for “export of service”.

The definition of “export of service” is similar to the present law, and therefore no new conditions are prescribed. However, place of supply rules would need to be evaluated on a case-to-case basis to determine the tax applicability on such services.

The default rule for place of supply for export of service shall be the location of the service recipient, where the address on record of the recipient exists with the exporter. Hence, it will be critical for exporters to ensure that the address of service recipient on record can be established before the authorities on request.

The typical IT/ ITES services that may fall under the default rule include software development, BPO operations, software consultancy, etc. Apart from these, certain services like software support/ maintenance and intermediary services will also move to the default rule, as there are no exceptions carved out for these, unlike under the present law.

There are exceptions to the above default rule, wherein training services could be based on the performance location of training, but at the same time, online training is not specified, and therefore could fall under default rule.

Key Action points

- A detailed analysis of the nature of services and its place of supply would need to be carried out to determine whether the services would be treated as exports and zero rated.

3. GST credits and refunds – impact on cash flow requirements

The term, “input tax” has been defined in a wide manner to cover GST paid on any goods/ services used in the course or furtherance of business, and includes tax paid on reverse charge basis.

While all inputs, capital goods and input services in relation to business should be covered, however, restrictions in credits (similar to those under the present law) will continue, particularly for those input services used primarily for personal use of any employee. It may be noted that rent-a-cab service, which is a key input service for the IT/ ITES sector, which is not allowed in the present regime as input service, has not been restricted from availment, and therefore should be allowed. Credits in relation to construction of immovable property, employee life insurance and general insurance are under the restricted category and would not be available.

While certain conditions are prescribed for availment of credit, a key condition is that the tax charged by the supplier, on which the recipient is entitled to credit should be paid to the appropriate government, which shall bring onerous compliance requirements upon the recipient to verify whether the supplier has discharged its tax liability. While the GSTN system could enable fulfilment of this requirement based on the matching principle, inserting this as a condition may require discharge of responsibility on the recipient.

In case of vendors charging GST for common input services which may be billed at the head office, the company will distribute the credit received at the head office as an Input Service Distributor to the relevant office to whom the input service is attributable, in a proportionate manner.

With respect to refunds, it would be important to note that companies would need to deal with both, the Centre and State governments, and therefore there would be duplication of the refund procedures.

However, refund provisions specifically provide for sanction of 80% of refund to exporter of goods or services. Detailed mechanism for the same is yet to be notified. This will be a welcome relief for the sector, given that refund claims are often not processed for long periods.

Refund application has to be disposed by way of a proper order within 90 days from the date of receipt of application (which is complete in all respects), else the authorities would be required to pay interest on delay beyond 90 days. Issues could arise as to when the application can be considered as complete in all respects, and therefore show-cause notices for rejection of refund claims may still be issued in order to obtain further details, thereby extending this time limit.

As per the transition provisions, all pending refunds under earlier law would be processed and disposed as per the provisions of earlier law. Any refund found eligible would be paid in cash. However, where any refund is fully or partially rejected, the provision mentions that such amount shall lapse. Clarity should be sought on whether such rejection can be appealed against. Clarity is also awaited on whether pending refund balances (that are disputed) can be transferred as credit under the GST law, or would have to be set aside separately to not form part of the credit pool.

Withholding or deduction of eligible refund amount:

- In case of any pending demand that has not been stayed by any court, the refund amount can be withheld and not issued.
- Refund can also be withheld if appeal is not filed within due date for filing appeal, or in cases where stay is not obtained within thirty days from the due date for filing the appeal.

There appears to be no restriction on payment of reverse charge liability using credit. Restrictions may be prescribed at a later date.

Key Action points

- This is an important aspect of GST, as companies need to ensure that input credits are availed without any loss of credits in the system. The IT systems of companies need to be ready to capture all credits in line with the provisions.
- Therefore, vendor management will become critical, and companies would require their vendors to ensure that their GST returns are filed after discharging appropriate liabilities accurately.
- Companies will have to determine situations where credits may be utilised in various offices from where taxable supplies are not made, and therefore evaluate possible alternative business models
- On refunds, representations need to be made in respect of the following:
 - In order to reduce the quantum of refund, GST on reverse charge may be exempted for a 100% exporter of services, as the same sum would need to be refunded again by the respective governments. Alternatively, the liability under reverse charge may be discharged through utilisation of credit.
 - Delete provisions where refund may be withheld or deducted on account of various litigation matters unrelated to the refunds.
 - Remove restrictions on credit eligibility on various other services like life insurance, general insurance, etc.

4. Continuation of exemptions for STP/ SEZ units

No exemptions have been specified in the draft law for STP and SEZ units. Upfront exemption from customs duty/ excise duty for STP units and SEZ units (including service tax and CST exemption for SEZs) may not continue as GST will be payable on imports or procurements as per the draft law.

The GST paid on such procurements will be eligible as refund and therefore, will impact the working capital requirements of such units.

The efficacy of the STP scheme therefore seems doubtful upon transition to the GST regime, as the benefit may be restricted only to BCD paid on import of non-IT products.

Upfront exemption of service tax for SEZ units (by way of Form A1/ A2) is also likely to be converted to refund.

Key Action points

- Companies need to evaluate continuing under these export schemes (especially under the STP scheme) given that no other indirect tax benefit may be eligible, other than BCD on import of non-IT products
- Industry to represent for continuation of benefits, at least under the SEZ scheme, given that the SEZ Act provides for benefits to be provided. However, the impact of GST credits for local suppliers to such SEZ units would need to be evaluated before making such a representation.
- Companies need to prepare for filing refund claims in each State based on each registration obtained

5. Domestic IT services

For IT companies having operations across India and providing services to customers located across India, the issue arises as to where to pay GST, and whether this would require splitting of invoices based on various locations of the service provider or the service recipient.

For this purpose, the draft law requires the determination of the location from where the services are provided and the place of supply of such services, so that GST may be paid to the appropriate government.

In the context of determination of the location from where services are provided, the draft law provides clarity by defining the term “location of supplier of service” and the place of supply of services is determined based on the “location of recipient of service”. With the assistance of these terms, the appropriate location for billing and the type of GST can be determined.

A related issue arises on utilisation of input credit accruing at multiple locations of the service provider, specifically where the GST may be discharged at a single location. The concept of Input Service Distributor has been introduced in order to transfer the credits, but only in relation to common input services, and therefore it may not be useful to transfer all credits to the billing office.

Key Action points

- Companies would need to carry out detailed analysis of the above based on their fact pattern in order to determine the billing location and requirement to split invoices to customers. This would also require amending the contracts to address the above requirement, in case the need arises.
- The issue on utilization of credits accruing at multiple locations would also need to be factored in for the purpose of the above analysis.
- Detailed compliance requirements would need to be adhered to as a fallout of the above.

6. Taxability of software transactions including cloud computing

Packaged software provided on media is likely to be covered under “goods”, and therefore is likely to be taxed based on the rate of tax and place of supply for goods. However, customised software may not qualify as “goods”, and therefore may be treated as services.

However, with respect to software supplied electronically, the same may not be covered under “goods” as the definition of goods does not include intangible property. Hence, it would be covered under “service”. This is likely to put to rest the vexed issue of dual taxation of software supplied electronically under the present laws.

In the context of cloud computing, the draft law provides that transfer of right in goods without transfer of title, including leasing transaction, shall be treated as a service. Hence, cloud services shall be treated as supply of “service” and therefore, the debate of dual taxes of VAT and service tax will not arise under GST.

Key Action points

- Companies would need to evaluate their business models involving software to determine when it would qualify as “goods”, and when as “service”.
- As the different treatment to packaged software on a media and electronically supplied software as “goods” and “services” respectively would lead to disputes on classification, rate of tax and place of supply of software, it should be represented to the government that a separate treatment for all software transactions as “services” should be brought out in Schedule II in order to avoid litigation, as the mode of delivery should not impact the taxation of software.

7. Transactions between head office and branch offices located outside India

Services provided to overseas branch would not be eligible as export of services due to specific exclusion for such transactions in the definition of “export of service”. This is similar to the existing provisions for export of service to overseas branches.

This could entail reversal of input credits as such supply would be treated as non-taxable and not as zero rated.

Definition of import of service also excludes services imported from overseas branch. However, the law has certain contradictions and therefore clarity to be obtained on this.

Key Action points

- Companies having presence through branches outside India would need to analyse applicability of these provisions and understand the GST implications on their business models, and thereafter evaluate various alternative models as may be required.

8. Input Service Distributor concept (ISD)

ISD concept has been proposed for transfer of credit of input services between two or more locations. ISD can transfer credit of all types of GST (CSGT, SGST or IGST). Further, ISD can be any supplier of goods or services. Considering the possibility of multiple registration State-wise, ISD could be used as a tool to ensure optimal utilisation of head office related credit, thus resulting in actual reduction in cost.

Key Action points

- Locations to be identified where there may be accumulated credit and there may not be sufficient output liability – ISD registration may be taken in such State to distribute credit to other locations

9. Impact on ongoing contracts

Specific transition provision has been stipulated that in case of periodic supply of goods/ services, GST Act would not apply on advances received prior to GST law for goods/ services to be provided during GST regime, provided tax has been paid on the same. This provision does not cover a scenario where tax has not been paid, but is payable under the earlier law post-enactment of GST regime.

Also, there is no provision for treatment of supplies prior to GST law where either the invoice has not been raised for the same, or payment has not been received, or tax has not been paid prior to enactment of GST law. This could result in dual taxation under both, the previous regime as well as the GST regime.

Companies would need to examine coverage of the transition provision as to whether implications for all its possible transactions during the transition period are clear. Accordingly, necessary representation would need to be made for clear transition provisions.

Key Action points

- Representation to be filed to provide more clarity on transition provisions for ongoing contracts

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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