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Research Article

A STUDY ON IMPACT OF GOODS & SERVICE TAX ON BANKING SECTOR: AN ANALYTICAL SIGHT

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ABSTRACT

Banking sector plays a very crucial role in a macro economic and monetary policies of any country overall framework and the business dynamics of this sector largely differs from other sectors. The regulatory framework for this sector is very strong and leaves no room for any discrepancies. Banking sector is with multiple technologies, regulatory and demographic factors cutting across the length and breadth of the value chain. Banks are the largest financial sector in India. The landscape of India's financial sector is changing widely. Banking adopted in differentiated channels and technology could help in a multi-fold increase of reach in rural and remote areas. Goods and service tax for the financial services sector would be a major transformation as it would have an impact on the financial product, the information technology system, processes and a shift from centralized compliance to the state wise compliance. This article lay down various issues that a Banking sector may face due to advent of GST and the suggestions so as to amend the rules, wherever required to be address the negative impact of GST on the Banking sector. GST may come into expanding the cost of the saving money and budgetary administrations. 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.

INTRODUCTION

The GST will introduce areas that will benefit the customers, whereas there will also be areas where the consumers may have to shell out more. The banking and financial sector is one such area that is being predicted to get a little more expensive for the consumers compared to what it is today after the implementation of GST. GST for banks and financial services will require a shift from centralized compliance to state-based compliance and will have a noteworthy impact on financial products and IT systems. 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.

Issues in GST on Banking Sector

All the banks have a centralized registration under the Service Tax laws for all its branches which exists in India. Banks having branches in multiple states& Union Territories (UT) will be required to obtain the registrations in each such state & Union Territory in the GST regime. Such requirement will have a huge compliance burden on the banks. Further, high coordination and control between the banks within and outside state for tax matters needs to be placed. Moreover, under GST, accounting, administration, financial records etc, would be required to be maintained for each state-wise separately. This will be highly cumbersome and challenging. Since, it will be difficult for the Banks to cope up with such radical change which is taking state-wise registrations, filing multiple returns state-wise, multiple audits and assessments; especially in a scenario where banks have presence in almost every state and

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union territory of the country and with each state, each city, each locality has a branch of the bank.

Further, even state-wise regional banks do not have capabilities to coordinate and receive information from all the branches within the state and comply with the tax requirements. With so many branches, the entire coordination and assimilation of information which takes place for compliance by each state regional bank shall be a big challenge. Therefore, government must provide for some special scheme to the banking sector so that the high administration and compliance burden as placed under the GST is reduced as the business dynamics of banking sector largely differs from that of other industries.

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.

Bank will be able to set off their GST liabilities against credit which is received on the purchase of goods. Under the existing CENVAT mechanism, banks are eligible to take up the partial credit of excise duty and service tax paid on procurement of the qualifying goods and services which are used for the provision of output service but under GST law bank will take input tax credit which would be used by bank for payment of output liability. Banks will not get the input tax credit of State VAT paid on any goods procured by them. As all these indirect taxes will be subsumed in GST, banks will be able to take credit of GST paid on procurement of goods as well. GST Will help to reduce tax evasion. Under GST doing business will be easy. The increase in business will lead to additional demand of funds. Addition demand of funds will lead to increase in a number of transactions in the bank as the business and current scenarios ask to go for digital transaction. Presently, interest income and discount provided by the banks are covered under negative list, hence not taxable to service tax. Under GST, the term 'service' is defined in a wide manner to cover 'anything other than goods' which may cover interest as well. Governments across the world do not levy GST on interest. The GST Law in India too should clarify if interest is outside the ambit of GST. If 'interest' is not expected to attract GST, it will have implications on input tax credits claimed by banks. Further, such a move would have larger economic issues. Therefore, we suggest to follow the current scenario where in the service tax law, interest is kept in the negative list, similarly interest can be kept in schedule 3 of the GST law so that it neither amounts to supply of good nor service and therefore no GST would be applicable on the same.

The issues and impacts pertaining to the provisions in the Model GST Law

Widespread number of branches; registration a hassle

Currently, a NBFC, Banks with pan-India operations can discharge its service tax compliances through a single `centralized' registration. However, under GST, such Banks/ NBFCs would need to obtain a separate registration for each state where they operate. In addition to registration, compliance burden about filing of returns has also increased substantially - in terms of the periodicity of returns, number of return formats and level of details required in these returns.

Input Tax Credit leveraged and de-leveraged

Currently Banks and NBFCs majorly opt for the option of reversal of 50% of the CENVAT credit availed against inputs and input services whereas CENVAT credit on *capital goods* could be availed with no reversal conditions. Under GST, 50% of the CENVAT credit availed against inputs, input services and capital goods is to be reversed which leaves them with a position of reduced credit of 50% on *capital goods* thereby increasing cost of capital.

Assessment and Adjudication made bothersome

Assessment would be done by the respective state regulators under which the respective branch is registered. Now, every registered branch of banks and NBFCs must justify its position on chargeability in the respective state and reason for utilizing input tax credit in different states. As under GST more than one adjudicating authority will be involved, each authority may hold different opinion on the same underlying issue. This contradiction in opinion will prolong the adjudication process. Currently, a tax payer is adjudged by a single adjudicating authority on an issue involved. Under GST different adjudicating authority may take different view on the same issue. Clearing up and dealing with the difference of opinion provided by different adjudicating authority would be difficult.

Issues related to revenue recognition under GST

Account Linked Financial Services

The place of supply will be the location of the recipient of services on the records of the supplier of services. In the digitized and centralized scenario prevailing in India identifying the state of location of service recipient will be quite difficult. In cases where the service recipients like professionals, manufacturers, traders and other workers often shift from one place to other in search of better opportunities, the service provider may have different address namely permanent address, current address, address of communication and KYC address

Non-Account Linked Financial Services

The place of supply of service here would be location of service provider. This will again hit such companies which are widespread in remote location to establish their presence but operate and transact from back office located in some other state.

Actionable Claims

Actionable claims do not constitute as a service under Service Tax, no tax is payable under current regime. Under GST actionable claims are now included in the definition of supply of goods. Services provided from bills discounted to securitization will now be taxed as an effect B2C and B2B majorly.

GST and Its Impact on Banks

The GST will replace at least 17 central and state taxes to make way for a single, unified taxation system and will impact almost all industries. The GST will introduce areas that will benefit the customers, whereas there will also be areas where the consumers may have to shell out more. The banking and financial sector is one such area that is being predicted to get a little more expensive for the consumers compared to what it is today after the implementation of GST. GST for banks and financial services will require a shift from centralized compliance to state-based compliance and will have a noteworthy impact on financial products and IT systems.

The overall impact could be nominal but once implemented, both, existing and new policyholders will have to bear the additional cost. If the current premium of a term plan is Rs 10,000, (excluding the service tax of 15 per the GST impact will up the premium including tax by Rs 300 i.e from Rs 11,500 to Rs 11,800. While, comparing premium especially of term plans, make sure you are looking at premiums including or excluding GST for all the insurers. Nothing changes in the selection process as the GST impact will be same across insurers. Stick to a proper selection process while getting the right insurance policy.

The impending implementation of GST would undoubtedly impact one's personal finances especially when it comes to financial services, albeit marginally. From the present rate of 15 percent, the GST on banking, insurance and investments such as real estate, mutual funds will see a hike of 3 percent as the GST will now be 18 percent on them.

Transaction fees in financial services are likely to increase as the government has put these under the 18% tax bracket in the new GST regime. These services were so far taxed at 15% and the hike in the tax rate means that individuals will have to pay Rs 3 more for every Rs 100 paid as charges/fees for banking transactions. It may be mentioned that recently several banks starting with SBI introduced or increased service charges for multiple banking transacactions including cash withdrawals exceeding a certain number of times in a month.

Tax Rate

Currently banking and financial services are taxed a service tax of 15 percent. The GST is being speculated to have tax rates between 18 to 20 percent. This implies that banking and financial services are set to become expensive for the consumers. Apart from the taxes, there will also be regulatory compliances that banks and consumers are expected to follow under GST. Since IGST will be divided into CGST and SGST, there will be different sets of GST compliance processes that need to be abided by.

Also, there are several banking activities that are currently exempt from service tax, e.g. Fund-based activities like interest to be paid on deposits or savings accounts, and loans disbursed. These services might incur GST unless exclusively mentioned otherwise.

Collateralised Borrowing and Lending Obligation (CBLO)

CBLO is a RBI backed obligation between a borrower and lender that defines the terms and conditions of a loan. Currently, the fee, discount or the interest on CBLO is exempt from service tax. As of now, service tax for financial services is imposed on fee-based activities like processing fee and transaction fee. However, revenue from income-based activities like interest, investment, propriety trading etc. is excluded from the tax ambit. With the GST coming into picture, the government should make provisions for clear demarcations between fee-based and fund-based transactions. If this demarcation is not made and if fund-based transactions are not exclusively exempted, revenue earned from instruments like the CBLO will also come under the blanket of GST and the GST tax rate is expected to be higher than the current one.

Finance Lease

Under the current system of taxation, both VAT and service tax is applicable on finance lease transactions. Even non-financed lease transactions are subject to VAT. However, import of assets on lease basis does not attract VAT. With the GST law, a finance lease will be treated as the supply of goods, whereas an operating lease, as a service. Both will thus be subjected to GST. Additionally, the leasing of an asset out of India, will also come under the GST.

Business Process Change

Over the last decade, customers are used to utilizing banking services anytime and anywhere. Even while travelling a customer may access his account or use his card anywhere in the world. Under the GST, defining the location of service supply is a subject of cardinal importance. Therefore for abiding to the GST norms, a bank that has presence in only 15 states will need registration for the rest of the states and union territories. Similarly for loans, under normal circumstances, initial customer verification is done by local agencies, loan processing is done centrally, disbursement locally, and repayment by bank transfers/ECS is mandate. With GST, determining the point of supply for each of the processes will become extremely cumbersome. Some bank services to a customer are centralized (Demat Account, Wealth Management) whereas some others are localized (Savings Account, Personal Loan). Since GST is a destination-based tax, these services will call for additional compliance formalities and may increase the compliance costs courtesy multiple levels of assessments and audits under the proposed GST structure.

A painstaking one-time process that is now inevitable, contrary to a centralised registration of the Indian banks under the former tax regime reforms, demand a state-wise registration of all bank branches. This would considerably increase the initial workload as well as expenditure. Instead of two returns to be filed as a service tax assesse, given the nation-wide reach, most banks would now end up filing more than 60 monthly and annual returns, collectively.

This transformation directly authorises state regulators, with which the branch holds its registration, to conduct assessments regarding the branch's utilisation of GST. In addition to this, transactions between branches would also be considered taxable under this context. This means that a transaction between two branches of the same bank registered under different states would be taxed as the location of the supplied services changes. Technically, this 'self-service' tax would be difficult to track considering the volume of transactions that are carried out on a daily basis. Such complexity proves to be extremely difficult to overcome as banks continue appealing for amends in the current framework.

GST provides an important functional control as banks get to decide whether a transaction would fall under Central GST (CGST), State GST (SGST) or Integrated GST (IGST) bracket. This revamped registration compliance compels financial institutions to pinpoint the origin of operations for both individual and commercial consumers of financial services. For individuals, the registration for their banking and financial needs would be done at the state level where they are currently residing. It is difficult to manage these accounts knowing how commonly individuals change their state of residence while seeking better career opportunities.

Similarly, to ascertain a centralised location (state) of operations for an organisation providing services or products pan-India is an almost impossible task. This raises an array of concerns with respect to the operational compliance of financial organisations with multiple state authorities. Restructuring and maintaining the records of millions of individuals and organisations pose a challenge that would require careful planning in order to be executed to fruition.

Awaiting implementation, the Indian financial sector is in a fix regarding the renewed transaction handling, registration compliance, operations, and information systems, since GST implementation demands restructuring these components in their entirety. All laid out straight, the implementation of GST will surely change the functioning of the Indian tax regime, especially for its financial institutions.

Difficulties to Banking Industry

- All the bank need to register for their all office location.
- They have to maintain separate books of account to have a control for all input tax credit and utilized and unutilized credit.
- Due to registration of all location Many banks and financial institutions may be in for a lot of trouble as they could just see the complexity in paying taxes increase under the GST.
- Complying with the requirements of reverse charge and partial reverse charge mechanism would add to further compliance costs.

Benefits to Banking industry

- Bank will be able to set off their GST liabilities against credit received on purchase of goods.
- Under the existing CENVAT mechanism, banks are eligible to take partial credit of excise duty and service tax paid on procurement of qualifying goods and services which are used for provision of output service.
- Banks do not get input tax credit of State VAT paid on any goods procured by them. As all these indirect taxes will be subsumed in GST, banks will be able to take credit of GST paid on procurement of goods as well.
- Input tax credit is not allowed as per current CENVAT rules. But under GST regime input tax credit will be allowed which would be used by a bank for making outward supply in the course of
- GST Will help to reduce tax evasion. Under GST doing business will be easy. The increase in business will lead to additional demand of funds. Addition demand of funds will lead to increase in number of transactions in the bank as the business and current scenarios ask to go for digital transaction.

Objectives of Goods and Service Tax

GST is proposed to fulfill the following objectives:

- GST would help to eliminate the cascading effects of production and distribution cost of goods and services.
- This would help to increase GDP and then to economic condition of the country.
- GST would eliminate the multiplicity of indirect taxation and streamline all the indirect taxes which would be beneficial for manufacture and ultimate consumer.
- GST would be able to cover all the shortcomings of existing VAT system and hopefully serve the economy health.

Critical Implications of GST on the Banking Sector

The banking sector is one of the largest services sectors in India. The implementation of the Goods & Services Tax (GST) will likely prove to be a challenge for the sector on two counts - First, due to the higher GST rates compared to the current service tax rate and second, due to the vast geographical reach of most banks.

With the GST coming close on the heels of demonetization, the banking sector needs to ensure that they are ready for this new tax regime. In this article, we will cover 4 critical implications of GST on the banking sector to help banks plan their GST implementation strategy.

Substantial Increase in Compliance

GST is a parallel tax regime where the States and the Center, tax the payer in one go. Hence, banks may need to obtain State-wise registration in every State where they have a branch. In case a bank has multiple branches in one State, only one registration is required for all the branches in that State. However, most banks have a multi-state presence. State-wise registration will therefore lead to a substantial increase in compliance levels, especially because most banks have obtained a 'centralized' registration under service tax. So, currently, a bank may be filing only two returns on an annual basis as a service tax assesse, but with GST, the bank might be required to file as many as 61 returns per year for every State they are present in (five returns per month plus one annual return).

Determining Place of Supply Could be Critical

GST is a 'place of supply' based tax regime. Hence, for every transaction in GST, the bank will need to determine the place of consumption where GST will be paid. With bank branches conducting several transactions, both within and outside States, determining the place of supply will not be very easy. The Model GST Law casts the onus of determining whether a transaction is 'intra-state' or 'inter-state' on the assesse. So, banks will need to decide whether the payment is against

Central GST (CGST) and State GST (SGST) or Integrated GST (IGST), based on the type of transaction. Moreover, inter-state supplies of goods or services (or both) between two branches of the same bank, located in two States, will also attract IGST. The GST charged will be available as credit to the receiving branch; however, tracking such transactions could prove to be a cumbersome task. Services being intangible in nature, proxy rules/ provisions are prescribed in the GST framework to help the assessee determine the place of consumption. Though, typically, the place of consumption for banking services (as per revised draft IGST Act) is the location of the recipient of services on the records of the supplier. But there is ample scope for wrong determination for a pan-India bank as there could be a dispute on who the service recipient is. Further, in cases where there is a dispute over the place of supply of services, the taxpayer may get entangled in legal disputes. Currently, the GST legislation provides that if an assessee wrongly pays, say CGST and SGST (on a belief that the transaction is intra-state), instead of IGST, then they will have to pay the correct taxes (i.e. IGST) again and claim a refund for wrongfully paid taxes. Ideally, instead of putting the onus on the taxpayer to determine whether the transaction is intra-state or inter-state, the GST law should provide for a simpler redressal mechanism.

Taxability of 'Interest'

In the current tax regime, the service tax legislation does not tax 'interest'. But with GST, the term service' is defined in a wide manner to cover 'anything other than goods' which may cover interest as well. Governments across the world do not levy GST on interest given the fact that there is always a debate on whether interest is the time value of money or a consideration for lending money. The GST Law in India too should clarify if interest is outside the ambit of GST. If 'interest' is not expected to attract GST, it will have implications on input tax credits claimed by banks.

Paying GST at Applicable Rate

With GST, services are expected to attract 18% GST. This rate is higher by 3% from the current service tax rate of 15%. This may make banking services such as issue of cheque books and demand drafts more expensive, particularly for retail customers. Another point to note is that these days banks also deal in commodities such as gold / silver where a concessional GST rate is expected to be applicable. Therefore banks need to be careful in paying GST with the appropriate applicable rate on different products.

CONCLUSION

Bank will be able to set off their GST liabilities against credit received on purchase of goods. Under the existing CENVAT mechanism, banks are eligible to take partial credit of excise duty and service tax paid on procurement of qualifying goods and services which are used for provision of output service. Banks do not get input tax credit of State VAT paid on any goods procured by them. As all these indirect taxes will be subsumed in GST, banks will be able to take credit of GST paid on procurement of goods as well. Banking sector plays a very crucial role in a macro economic and monetary policies of any country overall framework and the business dynamics of this sector largely differs from other sectors. The regulatory framework for this sector is very strong and leaves no room for any discrepancies. Unlike, other businesses where there are many un-organised ways of style of workings still prevail, same is not the case with this sector which is largely organised in nature. Therefore, any issues for this sector has to be closely looked at and timely resolved so to that larger economic interest of the nation is achieved.

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