



Demystifying the myths of GST



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Introduction

With the 122nd Constitutional Amendment Bill becoming the 101st Constitutional Amendment Act after the Presidential Assent on 8th September, 2016, we are closer than ever to that day when the GST becomes a reality. This realization has started sinking in within the stakeholders and they are now trying to figure out as to how the GST will impact them. With the Government presenting a rather too optimistic picture about GST, the media giving its biased opinion and through hearsay from the other so called experts, these stakeholders have developed certain myths about this tax reform. A careful analysis of the Model GST law and the business process documents released by the Government will reveal some of the realities of the GST law which might have escaped the public eyes. This is an attempt to demystify these obscurities by visualizing these myths in its true light.

Myth 1: There will be seamless flow of input tax credit without any barriers or restrictions.

GST is supposed to integrate the goods and services together and hence it was expected that there would be no restriction on allowance of input tax credit provided they are used for business purposes. But the provisions of Input tax credit of the Model GST law enlists a number of items on which no input tax credit will be allowed though it may easily be argued that they have been used for business purposes.

Input tax credit on motor vehicles except when used for transportation of goods or passengers or for imparting motor training has been disallowed. There can be instances of Motor vehicles being used exclusively for business purposes for which the Input tax credit will still not be available. For example, motor vehicles engaged by the business exclusively for the transport of its executives to/from office should be allowable as input tax credit under GST but is unfortunately not as per the Model GST Law.

Goods and/or services used for consumption of employee has been disallowed as well. There can be quite a number of goods and/or services which are used by employees for business purposes. Not allowing input tax credit in these cases defies economic sense and could well lead to litigations. For example, outdoor catering services provided to employees within office during the office hours are exclusively used for business purposes. This is because without these facilities, it is impossible for the employee to work. But, this is not allowable as input tax credit under GST.

Another major item of disallowance of input tax credit is the goods and/or services acquired by the principal for construction of immovable property. Developers constructing residential or commercial complexes may not be able to obtain the input tax credit on the goods and/or services utilized for such construction. Even works contract given by these developers to contractors may not be allowable. This may be very detrimental to the construction industry. In fact, this is also a regressive provision from the perspective of any industry which constructs its place of business. For

example, a cement manufacturing company hiring a contractor to construct its factory will not be allowable input tax credit on such construction cost.

Myth 2: GST will remove multiplicity of taxes completely as it will subsume all indirect taxes within its fold

Though GST will subsume quite a number of indirect taxes within its fold, certain levies have also been kept out of it.

Basic Customs Duty, Excise duty on Tobacco Products, Export duty, taxes on petroleum and petroleum products, state excise on liquor, taxes on electricity, environment tax etc. will be outside the purview of GST. To the extent of these taxes, the existing levies will continue and the multiplicity of indirect taxes will continue.

Myth 3: One nation one tax means that there will be only one GST levied throughout the country instead of multiple tax levies like today

Since India is a federal country, autonomy of the Centre and States is of prime importance when it comes to collection of taxes. Both the Centre and States want their share of taxes without the other encroaching onto their territory. So, India will be adopting a dual taxability model.

On every supply, a part of tax will be going to the Centre and the rest to the State where the place of supply occurs. In case of intra state supply, CGST and SGST will be levied. The portion of CGST will be accruing to the Centre and the SGST to the State. In case of inter-state supply, IGST will be levied which will be the sum of CGST and SGST. This IGST will be apportioned between the Centre and the State as per their share.

So, instead of the multiple tax levies today, GST will be brought in the form of CGST, SGST and IGST.

Myth 4: The problem of levy/payment of one tax instead of the other will not occur anymore in GST

In case of works contract, air conditioned restaurants, software etc. there are a number of disputes as to whether VAT or service tax or both will be levied and what will be the component of each. Due to interpretational differences, assessee at times end up paying taxes under both the regimes. If one pays a higher tax in one of the regimes, then it does not absolve him of the tax liability in the other regime. This is because Service tax and VAT are Centre and State levies respectively and they cannot encroach upon each other’s revenue share.

Under GST also, if a taxable person ends up paying CGST/ SGST on a transaction which is later held to be an inter- state supply, then he cannot adjust the taxes already paid for payment of IGST. First, that person has to pay IGST and then he will be eligible to claim refund of CGST/SGST already paid under the refund provisions. With a bleak

history of the Government in providing refunds on time, the businesses might end up paying taxes twice on the same transaction.

Myth 5: State boundaries will not hamper the utilization of input tax credit anymore under GST

It should be noted that every taxable person will need to take registration on a state wise basis. Different registration numbers will be allotted in different state. Even within the state, if a person opts for multiple registration for multiple business verticals, he may do so. Each registration will be considered as independent for the purpose of input tax credit.

Input tax credit between different registrations cannot be set off between each other or transferred to one another except when there is a supply between the two registrations or one transfer the input tax credit to the other as an input service distributor

So, there might arise situations wherein the taxable person might be having excess input tax credit in one registration and is paying taxes through the electronic cash ledger in the other registration. This requires careful business and strategic planning from the point of view of the entity as a whole.

Also, if a person has SGST of another state in his input tax, such amount will not be allowed to be set off against his output tax liability. For example, if a dealer in Gujarat buys an article from Maharashtra without quoting his GSTN and the Maharashtra dealer charges CGST and SGST, then the SGST of Maharashtra will not be allowed as Input tax credit to the Gujarat dealer. The Gujarat dealer can only claim input tax credit of SGST charged within Gujarat. To claim the input tax credit of another state, IGST should be charged instead of CGST/ SGST.

Myth 6: There will be no cascading effect of taxes at all under GST

Cascading effect refers to the phenomenon of tax on tax. For example, On an excisable product getting removed by the manufacturer, both the excise duty and VAT needs to be paid and the valuation for the purpose of VAT includes the portion of excise duty. Under GST, though this cascading effect will be reduced to a large extent, it will not be completely eradicated.

Under GST, there are quite a few taxes which are not getting subsumed. The levy of these taxes along with GST will still continue the cascading effect as under the earlier regime. For example, taxes on electricity will continue under the existing law. However, goods used for setting up a power plant will be liable to GST and the same will not be eligible for set off for providing outward supplies. So, this will increase the cost of goods procured from a business point of view and create a cascading effect.

Also, in case of composition scheme, the output tax paid by the supplier will not be eligible as input tax credit to the recipient. This will create a distortion in the input tax

credit chain and will result in an increase in the cost of the goods/ services by means of cascading.

Myth 7: There are no provisions for revision of returns under GST, so any mistake committed in the return cannot be rectified

Even though there is no provision for revision of returns, there is scope for rectifying omissions and errors. If any taxable person discovers any error or omission in the return of a prior period, then he can rectify these in the return for the tax period during which he notices them. For example, if a person detects an error for the month July 2017 in September 2017, then he can rectify the error in the return for the period September, 2017.

Myth 8: If the supplier has not made the payment of GST/ not filed his return/ filed incorrect particulars of the recipient in his return, the input tax credit to the recipient will be disallowed immediately without any recourse

Under GST, the input tax credit of the recipient is dependent on the fact whether the supplier has complied with the formalities of making the payment and filing the returns with correct particulars of the recipient. If any of these are not complied with, the input tax credit is subject to disallowance. However, there is a provisional time limit for which the input tax credit will be allowable in the hands of the recipient even if the supplier has not made the requisite compliances. The Government after matching the output tax paid by the supplier and the input tax credit claimed by the recipient, will communicate the discrepancy to both the parties. If the discrepancy is not rectified in the month of receiving this communication, only then the input tax credit claimed by the recipient will be added to his output tax liability.

For example, if a mismatch for the period April, 2017 is communicated by the Government in June, 2017 and the same is not rectified within that month, the excess input tax credit claimed by the recipient will be added to his output tax liability in the return for the period July, 2017.

Myth 9: Compliance burden will ease out in GST for all the sectors which will result in a decrease of compliance cost

It must be emphasized here that GST is expected to bring uniformity of compliances as opposed to the different nature of compliances in the various tax regimes prevalent today. However, this does not necessarily mean that the compliances burden of the businesses will ease out immediately. To derive the true benefits of GST, it is of utmost importance that the IT systems and infrastructure of the taxable persons are robust and GST compliant.

Small suppliers from the unorganized sector will be the worst sufferers under GST. Since, the threshold limit of aggregate turnover in a financial year for the purpose of

exemption may be kept as low as Rs. 10 lakhs, a large number of small suppliers will be covered within the ambit of GST. The fact that the frequency of returns is very high further complicates the situation for them. Even the smallest of taxable persons have to file atleast 37 returns in a year. With the lack of resources at the disposal of these small suppliers, the GST may turn out to be a nightmare for them if they don't upgrade their infrastructure adequately to ensure GST compliance.

Myth 10: The Working Capital requirements will be lower under GST

It is important for businesses to analyze their specific situation with regard to working capital requirements and optimize the same under GST though proper planning. The notion that GST will bring in lower working capital requirements for every industry is not correct. Compliance of a number of provisions in the Model GST law will require an increase of working capital requirements as well. Few of these illustrative instances have been enumerated below.

Stock transfers under the current tax regime is not subject to VAT on production of Form F. However, any stock transfers between two units of the same entity are also covered within the definition of supply and hence will involve payment of GST. The amount paid as GST will however be available as input tax credit to the recipient unit and this can be claimed against the tax liability on its outward supply. So, bringing stock transfer within the ambit of GST essentially will catapult the liability of GST to an earlier date i.e. the date of stock transfer rather than the date of supply to an outsider. This will call for a higher working capital requirement for the entities.

Also, if any advance payment is received in respect of a supply then the same will be considered as time of supply under GST. At this point in time, the liability to pay will arise. Though this provision is largely similar to the Service tax law, it is sharp contrast to the Central Excise Law and the VAT law. The liability to pay excise duty under the Central Excise law arises only upon the removal of goods. In case of VAT, this liability occurs at the time of transfer of property in goods. The date of receipt of advance payment is immaterial in both the laws. Preponing the date of liability to pay tax in case of goods will definitely result in higher working capital requirements for the taxable person dealing in goods.

Also, the Government is planning to do away with most of the exemptions in GST. The incentives that need to be provided will be mostly provided by way of refunds. This way the input tax credit chain will not be broken. However, it will also result in payment of tax once and then claiming of refund. This cash outflow will necessitate the need for higher working capital.

Conclusion

GST is being touted as the most game changing tax reform of the country since independence. It is certainly going to affect all the businesses and professions throughout the country. So, it is paramount for the trade and commerce to make an impact assessment for their respective businesses. For that, they should rise above the myths of GST and have a transparent picture of tax reforms ahead of them. Only by seeing through these myths, true benefits of GST through strategic planning can be realized.

(This publication contains information for general guidance only. It is not intended to address the circumstances of any particular individual or entity. Although the best of endeavour has been made to provide the provisions in a simpler and accurate form, there is no substitute to detailed research with regard to the specific situation of a particular individual or entity. S. Khaitan & Associates or any of its officials do not accept any responsibility for loss incurred by any person for acting or refraining to act as a result of any matter in this publication)



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