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November 15, 2016

Mr. Arun Jaitley
Minister of Finance
Government of India
New Delhi

Subject: **Representation on key issues affecting the Information Technology Service Sector under the Model Goods & Services Tax Law released by the Ministry of Finance on June 14, 2016**

Hon'ble Minister,

At the outset, we wish to thank the Ministry of Finance for releasing the Model Goods & Service Tax Law (hereinafter referred to as the 'Model GST Law') and providing clarity on the structure of the much awaited indirect tax reform in India.

While the Model GST Law has brought clarity to the basic framework of the GST regime, some of the provisions provided therein is likely to cause hardship to the businesses, specifically the Information Technology services sector.

We have herein below summarized the key technical issues and our recommendations with respect to the same.

1. Need for centralized registration and compliance under CGST/ IGST law

Issue:

- The Model GST Law requires registration and compliances to be obtained in each State (by a supplier) from where a business or fixed establishment makes a taxable supply of goods/ services.

- Under the current regime for services, the service providers having multiple places of business throughout the country typically operate under a centralized registration model and compliances are centralized at one location where centralized accounting or billing is maintained. This is owing to the reason that at present Head office and Branch office are not two separate taxable persons. Consequently, presently, there is no challenge with respect to the scenario wherein expenses are incurred by the Head office and service is availed by its Branch office.

- Under the GST regime, owing to the introduction of concept of 'taxable person' under each state-wise GST law along with the absence of concept of centralized

registration, service providers would be required to operate under a de-centralized registration model with registration even for CGST/ IGST required to be obtained for each place of business. This would lead to administrative and compliance hardship for the companies across States.

- Service providers operating in multiple states, typically have single contracts with customer with delivery of such services being fragmented across several locations. Determination of value of IT service across each place of business, especially in case of single contract structure (both on services provided as well as input services received) would be a major challenge for service providers.

- Further, in case of pan-India contracts, there is no clarity on determining the "location of the service provider" and "location of service recipient". In other words, whether the actual location from where the service is performed would be treated as location of service provider or whether such location would be the location which has entered into a contract, is not very clear from the existing provisions in the model law. It is also not clear whether the service provider would be given the flexibility of choosing the location of service provider as per their convenience.

Recommendation:

- A centralized GST administration for service providers should be provided for CGST/ IGST as prevalent under the existing service tax law.

- Alternatively a methodology enabling centralized billing from one location with transfer of credits to such billing location from other locations should be enabled. This should be provided for B2B transactions at least, as there is no question of loss of revenue to any State given that the receiver (located in any State) would be entitled to avail credit.

- The aspect that service providers would have flexibility to choose the method of billing (either from contract location or from location where service is performed) would have to be clarified.

2. Continuation of current indirect tax benefits to SEZs w.r.t. upfront exemptions

Issue:

- In the Model GST Law there is no clear provision specifying the continuation of the current indirect tax benefits available to supply of goods and / services to a SEZ / SEZ unit.

- Discontinuance of upfront exemption as available under the current regime for procurement of capital goods, inputs and services would defeat the whole objective of rolling out of SEZ Scheme and would also be contrary to the provisions of the SEZ Act, 2005 which specifically provides for upfront exemptions from taxes. The SEZ Act is an Act passed by the Parliament where a particular benefit is extended which cannot be taken away by any other Act.

- Lack of upfront exemption to SEZ units would put such units at par with any DTA unit thereby questioning the need for continuing operations under the SEZ scheme.

Recommendation:

- Upfront exemption be retained for payment of tax (on inputs, input services and capital goods) by SEZ/ SEZ units under the GST regime.

3. Need for centralized refund processing claim

Issue:

- Under the proposed GST regime, it appears that a separate refund claim of the unutilized input tax credits would need to be filed in every State. Such efforts of multiple refund claims as against a centralized refund claim under the current regime would entail additional compliance and hardship on exporters.

Recommendation:

- The exporters should be allowed to file a centralized refund claim with the same being adjudicated at one location and refund being disbursed by each State, respectively.

- Also, it is recommended that the refund claim be provisionally granted on the basis a certificate issued by any Chartered Accountant and not only a Statutory Auditor.

4. Importation of service without consideration and not in the course of business

Relevant Provision – Section 3(1)(b)

- Supply includes importation of service, whether or not for a consideration and whether or not in the course or furtherance of business.

Issue:

- The above provision seems to suggest that import of any service by any company / person for business or personal consumption and irrespective of consideration would qualify as a taxable supply.

- Additionally, Schedule III, entry 5, suggests that there would be no threshold limit applicable for seeking registration if any person is liable to pay tax under reverse charge mechanism.

- This includes importation of service not in the course of or furtherance of business as well and therefore individual users would also be subjected to reverse charge GST.

- Conjoint reading of the above seems to suggest that any person would be bound to obtain registration and deposit IGST on import of services without consideration and without any threshold as well.

- This provision would lead to unnecessary hardship for both individual consumers of services as well as business entities.

Recommendation:

- The provision with respect to supply should be amended to include only importation of services **with consideration**. The determination of transactions without consideration specifically in the context of import of service where the service provider is outside India would be challenging and subject to dispute.

- This would also have challenges on valuation of such services without consideration given that the various provisions governing valuation provide for comparable value, or deductive or computed value, which cannot be applied in the case of import of service where the recipient is merely discharging the liability on behalf of the provider and the recipient would not be privy to comparable or deductive or computed values for such services.

- The above proposition of deleting this requirement also finds support from Schedule I of the Model GST Law that provides for the activities that would qualify as 'supply' without consideration. As importation of service without consideration does not fall under the scope of Schedule I, the same may be excluded from Section 3(1)(b) of CGST/SGST Act which treats import of services as supply.

- Further, the levy of GST should not be applicable on importation of service not in the course of or in furtherance of business. The provision relating to "supply" (Section 3(1)(a)) provides for supply only in the course of business but the provision for importation of service (Section 3(a)(b)) includes importation not in the course of business as well, which is discriminatory and shall lead to huge compliance burden on individual consumers or their overseas suppliers of services. Hence, it should be clearly specified that importation of service should also be in the course of business; alternatively this provision (Section 3(1)(b)) should be deleted given that the main provision of supply already covers importation of service as well.

5. ***Taxation of self-supplies including inter-branch supplies of <u>services</u> under Schedule I***

Relevant Provision:

- Schedule I of the Model GST Law provides for supply of goods and / or services by a taxable person to another taxable or non-taxable person in the course or furtherance of business as a 'supply'

Issue:

- The above provision seems to suggest that self-supplies or inter-branch supplies of **<u>services</u>** would also be included within the scope of Schedule I apart from self-supply of goods.

- This would lead to undue financial hardship and reporting burden on the companies which provides services to its branch offices across locations, without any consideration.

- Further, determining self-supply of services across states within the same legal entity may be practically impossible to track and determine.

- Further, taxing of self-supply of services from one state to another only increases the compliance burden in the hands of the assessees without any additional tax

inflow to the Revenue. This is due to the fact that supply from one branch would be eligible as input credit for the receiving branch from where the service may either be consumed in the same state or provided inter-state.

- Since credit is seamless and would adjusted with output liability that is billed to B2B or B2C customer, monitoring these self-supplies would be a futile exercise which would only increase compliance without any increase in Revenue.

Recommendation:

- To clarify that self-supplies and / or inter-branch supply of services without consideration to be outside the scope of 'supply.'

- Alternatively, necessary provision allowing transfer of credits from branch locations to central billing location should be made feasible.

6. ***Clarification on Valuation of self-supplies of services***

Relevant Provision:

- Rule 3(5) of the GST Valuation (Determination of the Value of Supply of Goods and Services) Rules, 2016 provides that where the goods are transferred from one place of business to another place of the same business, the value of such supply shall be the transaction value.

Issue:

- 'Transaction Value' has been defined under Section 15 of the GST law to mean price actually paid or payable for the said supply of goods and/or services where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply.

- There is no actual flow of consideration for movements of stock from one place of business to another. Accordingly, no price is payable for such kind of transactions and accordingly, concept of transaction value cannot be applied.

- A similar problem would arise in case of inter-branch supply of services since no price is actually paid or payable which can be considered as the transaction value.

- The GST Valuation (Determination of the Value of Supply of Goods and Services) Rules, 2016, further provide that where the value of a supply cannot be determined under Rule 3, same shall be determined by proceeding sequentially through Rules 4 to 6, which are (i) determination of value by comparison, (ii) computed value method and (iii) residual method.

- It may be noted that the present valuation rules are quite complex and provide wide ranging powers to the adjudicating authorities to question/ scrutinize the transaction value. This could in potential lead to disputes.

Recommendation:

- It is recommended that simplified principles for valuation of stock of goods and services (to be transferred to another place of business within a legal entity) should

be prescribed in comparison to the present draft valuation rules which are quite complex.

- Application of valuation rules attuned to goods under excise and customs could pose a huge challenge for services and could lead to unnecessary disputes.

- Also in case of inter-company self- supplies in B2B case since the credit will be pass through such stringent valuation rules will vitiate the regime leading to disputes.

7. ***Clarification on software supplied on tangible media***

Issue:

- While from the Model GST Law it could be inferred that electronic supply / download of software, not being tangible, would qualify as a service, no clarity has been provided with regard to supply of software on a media. The issue would get further complicated when a back up media is provided containing software, where the software has already been provided electronically.

Recommendation:

- To impede potential disputes on the classification of software and other intangibles when supplied on a tangible media, a specific explanation should be added to clarify the categorization of intangibles supplied on a tangible medium.

- The above would be especially important in the context of software supplies where the same software is supplied electronically as well as on media, i.e., as a back-up, software upgradation and maintenance cost.

8 ***Restriction on input tax credits***

Relevant provision:

- Clause (9) of Section 16 of the Model GST law provides for certain restrictions in the availment of input tax credit. These restrictions particularly apply to expenses incurred in relation to employees, wherein various employee related expenses would go up as the GST paid on such expenses would be a cost and not available as credit.

- For IT companies, especially, the employees are the key assets used for conducting operations and therefore expenses incurred in relation to employees become clearly linked to the business of the company and therefore should be allowed as credit.

Issue:

- Restrictions in Section 16(9) of GST Act disrupts the flow of tax credit and this provision seems to be a replica of existing CENVAT credit provision.

- Clause 16(9)(f) appears to cover wide scope of transactions which can lead to hardships.

Recommendation:

- Sub-section 9 of Section 16 should be removed to facilitate seamless credit of input supplies.

- Restricting the input tax on private and personal consumption should be narrowed to only include selective transactions and should not be extended to employee related transactions.

9. Matching of CENVAT credit

Issue:

- Section 29 of Model GST Act prescribes matching of output liability of supplier with input credit of recipient.

- It appears that the recipient of credit could be penalized for any fault of the supplier wherein in case of mismatch of the credits, the amount shall become the output tax of the recipient and therefore the recipient needs to discharge that liability.

Recommendation:

- The credit should be made available to the recipient of supply based on documentation maintained by the recipient. The recipient of supply should not be penalized for any fault or discrepancy in the hands of the supplier.

- The Government retains its powers to collect tax revenue from the supplier (by way of attachment of property/bank account etc.).

- Further, even under the current laws, credit is available immediately on receipt of goods/invoice for services. There is no need to track payment of taxes by the supplier and the recipient needing to ensure that the supplier has complied with GST laws for the availability of credit to the recipient.

- Hence this proposal of linking tax deposit with input credit entitlement should be dispensed with.

- At the least, to begin with, under GST, the matching concept should not be introduced from the beginning but can be introduced once the trade is familiar with the filing of monthly GST returns and thereafter bring in these provisions.

10. Clarification on concept of composite supplies

Relevant Provision:

Section 2(27) of the Model GST Law defines the term 'composite supply' as under:

*"**composite supply**" means a supply consisting of -*

(a) two or more goods;

(b) two or more services; or

(c) a combination of goods and services provided in the course or furtherance of business, whether or not the same can be segregated;

Issue:

- There are no specific provisions prescribed for the taxability of composite supply, such as, rate of tax on composite supply, time of supply, etc.

Recommendation:

- Specific provisions to be provided with respect to composite supplies, specifically, to treat composite supplies as either "goods" or "services" to begin with without requiring the split of the contract into goods or services, and also to address applicability of tax rate, time of supply and place of supply.

- Also, to clarify as to what would be the differentiator for such supplies vis a vis works contract.

11. Works contract to specifically cover annual maintenance contract and operation and maintenance contracts under its ambit

Relevant Provision:

- *The term 'works contract' has been defined under Section 2(107) as:*

"Works contract means an agreement for carrying out for cash, deferred payment or other valuable consideration, building, construction, fabrication, erection, installation, fitting out, improvement, modification, repair, renovation or commissioning of any moveable or immovable property".

Issue:

- It appears that the above definition does not cover annual maintenance contracts/operation and maintenance contracts of any movable or immovable property.

Recommendation:

- It is recommended that the definition of works contract should be suitably amended to specifically include annual maintenance contracts/operation and maintenance contracts of movable and immovable properties under its ambit since the said contracts involve both supply of goods and provision of services.

12. Clarification on taxability of spare / product movements for repair or warranty purposes

Issue:

- As per the Model GST Law, any supply is taxable irrespective of whether the same is supplied free or cost or for a consideration.

- In case of Annual Maintenance Contract (AMC) for products, such AMC typically involve provision of repair services and replacement of defective parts.

- Given that the contract is for supply of goods and services, it is likely to qualify as 'works contract' which is deemed to be a 'service'.

- In case of AMC the industry norm is that the entire consideration is paid upfront. Accordingly tax would also be paid upfront by treating the transaction as service.

- Subsequently, when there is a supply of part (in fulfilment of AMC obligation), there is no provision in the Model GST Law to exempt such supplies. Such supply of part should not be subject to a GST as the consideration for such supply is already in built in the AMC value which has already suffered GST.

- Further, if the AMC is executed in one state whereas the actual part supply happens from a different state (or to a different state), there no provision in the Model GST Law to address such situations.

- The above issues if not addressed would lead to double taxation of AMC supplies which is against the principles of taxation.

Recommendation:

- It is suggested that suitable provisions should be made in the GST Law to exempt supplies under AMC/ warranty obligations.

- Such exemption should also be extended to supply of defectives by the AMC receiver to the AMC provider

13. Registration requirement for a non-resident taxable person

Issue:

- A non-resident taxable person is defined as a taxable person who occasionally undertakes supply but has no fixed place of business in India

- The definition of "place of business" is also very wide wherein it covers a warehouse, a godown or any other place where a taxable person stores his goods, provides or receives goods and/or services.

- The definition of "taxable person" includes a person who is registered or supposed to be registered.

- From the above definitions, while a non-resident is defined as anyone who does not have a fixed place of business in India but carries out an occasional supply, the definition of "place of business" is very wide.

- There are several instances where companies located outside India, who are required to fulfill warranty or repair obligations, store their spares with third party logistics companies in India. These goods would be owned by the overseas companies, but would be stored by logistics service providers.

- While the necessary tax compliances would be fulfilled by third party logistics companies, given the wide definition of "place of business", it is apprehended that even the overseas companies would be required to obtain registration in India.

- Such a requirement, would cause considerable hardships to companies having warranty and repair obligations. Further, given that the tax obligations of such supplies are anyway complied by logistics companies or other appointed agents,

registration of such overseas companies would lead to unnecessary tax compliance without any additional tax obligation being cast on them.

Recommendation:

- The definition of "place of business" may suitably be amended to address the above anomaly.

- Necessary amendments may be made to definition of "non-resident taxable person" to only cover persons engaged in carrying out supplies on their own and not through third party entities or agents.

14. Research & Development Cess

Issue:

- **Article 270 of the current Constitution empowers the Union Parliament to levy a cess for any specific purposes, which shall be levied and collected by the Government of India and distributed in a manner recommended by the Finance Commission.

- Using these powers, the Government of India imposes the existing Research & Development Cess (R&D Cess) payable on the import of technical knowhow which is a cost to businesses.

- In the existing service tax regime, the service tax payable on payment of royalties / technical knowhow is reduced to the extent of R&D Cess paid.

- However, no credit of the R&D Cess is available to the businesses.

- There is no clarity on whether R&D cess would be subsumed under GST.

- Further, the Model GST law neither specifically provides any exemption from GST to the extent of R&D cess paid nor allow credit of R&D cess paid.

Recommendation:

- It may be clarified that R&D cess would be subsumed under GST.

- Alternatively, if such cess is not subsumed, credit of R&D cess should be allowed and such credit should be allowed to be adjusted against GST on outward supply of goods and or services.

We would urge the Government to kindly consider our recommendations / observations on the aforesaid provisions of the Model GST Law impacting economy, while finalizing the final GST Law.

In case you require any further information / clarification with respect to the above recommendations, we shall be happy to provide you the same.

We also request your good-self to grant us an opportunity of meeting with you in person to provide a detailed insight into our perspective and make submission on the aforesaid.

Thanking you and with kind regards,

Yours sincerely,

Madhvi Kataria

Madhvi Kataria
Deputy Executive Director