Journal Homepage: - www.journalijar.com

INTERNATIONAL JOURNAL OF ADVANCED RESEARCH (IJAR)

ISSN NO. 2320-5407

Article DOI: 10.21474/IJAR01/2032
DOI URL: http://dx.doi.org/10.21474/IJAR01/2032

*RESEARCH ARTICLE*

# IMPACT OF GST GOING TO OCCURE ON BANKING AND FINANCIAL SERVICE SECTORS

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*Manuscript Info*

*Manuscript History*

Received: 27 September2016
Final Accepted: 12 October 2016
Published: October 2016

*Key words:-*
GST, Inflation, Financial services, Life Insurance, Mutual Fund, Stock broking

*Abstract*

The Government of India is going to take a historical step towards tax structure. Total tax collection of government may be increased but the tax payer may have some less tax burden and very easy tax structure than complex nowadays. The new structure is implemented in whole of India except Jammu and Kashmir on 14th June 2016. With the implementation of GST a moderate increase in the cost of financial services such as loan processing fees, debit/credit card charges, insurance premiums, etc. is expected. Under GST, effective tax rate on fee-based transactions is expected to increase to 18-20%.



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## Introduction:-

Indirect taxes in India have driven businesses to restructure and model their supply chain and systems owing to multiplicity of taxes and costs involved. With hopes that the Goods and Services Tax (GST) will see the light of the day, the way India does business will change, forever.

Total tax collection in India (direct & indirect), currently stands at Rs 14.6 lakh crore, of which almost 34 % comprises indirect taxes, with Rs 2.8 lakh crore coming from excise and Rs 2.1 lakh crore from service tax. With the implementation of the GST (Goods and Services Tax), the entire indirect tax system in India (excise, state-level VAT, service tax) is expected to evolve. The tax revenue mix can change as per the economic condition of the country. In developing countries, Indirect taxes comprise a higher share of total taxes; in developed countries, their contribution is significantly lower.

**GST objectives: -**

1. Ensuring availability of input credit across the value chain
2. Minimizing cascading effect of taxation
3. Simplification of tax administration and compliance
   4. Harmonization of tax base, laws, and administration procedures across the country
4. Minimizing tax rate slabs to avoid classification issues
   6. Prevention of unhealthy competition among states
5. 7. Increasing the tax base and raising compliance

**Impact on inflation:**

Under the proposed GST, effective tax rate on goods (comprising around 70-75 % of the CPI basket) will decline. A significant proportion (35-40 %) of goods (majorly agriculture products) is not subject to tax and we expect a status quo in future.

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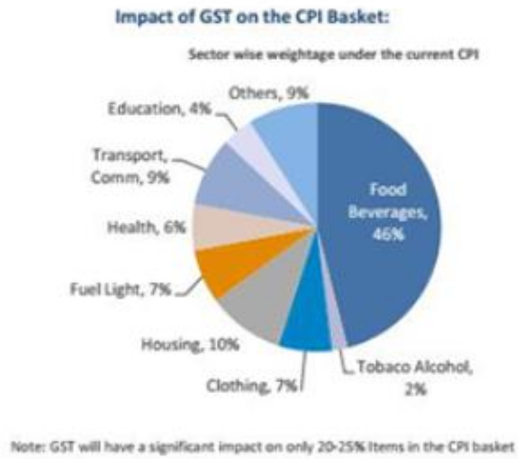
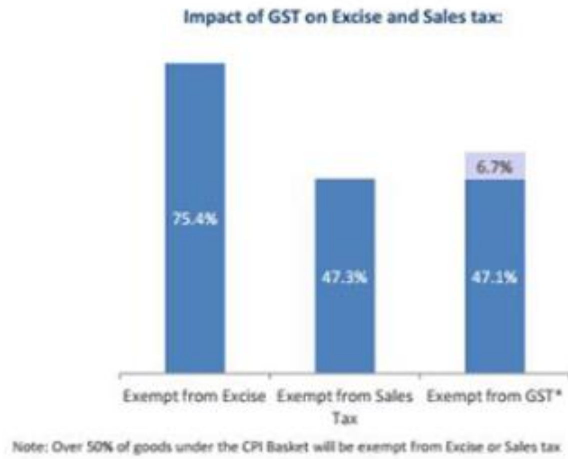
At present, services-oriented components constitute 25-30 % of the CPI basket with a major share belonging to housing, transport and communication sector. Service tax is not imposed on certain (12 % of the CPI basket) services and these services are expected remain exempt under GST regime. A hike in tax rate on services is unlikely to have any material direct impact on CPI. Thus, the overall transition to GST will not have a significant impact on inflation

**Sector wise impact of GST:-**




Source: Edel Invest Research

**India in the brinks of GST:-**
India finally seems to be on the cup of implementing the much-awaited tax reform of Goods and Services Tax (GST). With the release of the Model GST Law on 14 June 2016, we crossed a major milestone and have certainly moved a step closer to GST. Globally the trend for the Financial Services (FS) sector has been either complete exemption or partially subject to GST. In jurisdictions where it is partially taxed, the approach has largely been to tax Fee-based activities with restricted input tax credits, while keeping the Fund based-activities outside the tax net. GST for the FS sector would be a major transformation as it would have an impact on the financial products, the IT system, processes and a shift from centralized compliance to State-wise compliance. The industry would need to analyze the provisions of the Model GST Law and its impact on their business.

**Banks and NBFCs:-**
**Place of supply of FS Products:-**
Presently, the place of provision of services provided by Banks/ NBFCs to account holders is the location of the service provider. Thus, notwithstanding the fact that the customer may be outside India, service tax is payable.

The Model GST Law specifies the place of supply of services for banking and other financial services (BOFS) as:
- in cases where the services are linked to the account of the receiver, the location of the service receiver on the records of the service provider; and
- where the service is not linked to the account of the receiver, the location of the service provider.

**Interest Income:-**
Presently, services provided by way of extending deposits, loans or advances, where consideration is represented by way of interest or discount, is covered by the negative list of services. Thus, such income is not subject to service tax.

The Model GST Law does not specifically exclude applicability of GST on income by way of interest or discount. However, it is expected that such income by way of interest and discount would continue to be non-taxable, and it will be covered by the negative list of supplies.

**Free Supply of services:-**
Presently, as per the definition of the term, ‘service’, only those activities which have a consideration are liable to service tax.

However, the Model GST Law also proposes to tax services by a taxable person to another person in the course of furtherance of business, without any consideration. This proposal could have far reaching implications, as identification and value attribution for such supplies could be challenging. For example, customers maintaining minimum account balance are eligible for certain benefits and such free services could be subject to GST.

**Sale of securities:-**
Presently, under the State VAT laws, the definition of the term, ‘goods’ specifically excludes securities. Hence, VAT is not payable on sale of securities.

Under the Model GST Law, the term, ‘goods’ includes securities. However, it is expected that such a transaction would be covered by the negative list of supplies.

**Securitization transactions:-**
Presently, the definition of the term, ‘service’ specifically excludes actionable claim, whereas under the Model GST Law, the term, ‘service’ specifically includes actionable claim.

The BOFS sector is facing significant NPA challenges, and securitisation is critical to address the NPA issue. It seems that by including actionable claim, transactions such as securitisation could be subjected to GST. However, it is possible that securitisation could get covered in the negative list.

**Finance Lease:-**
Presently, finance lease transactions are liable to both, VAT and Service Tax, and ordinarily operating lease transactions attract VAT. Further, VAT is not payable on import of assets on lease basis.

Under the Model GST Law, a finance lease would be considered as supply of goods, and an operating lease would be considered as a service. Further, leasing of an asset from outside India, will be liable to IGST.

**Sale of Repossessed Assets:-**
Under the VAT laws, taxability of sale of repossessed assets in the hands of Banks/ NBFCs has been a contentious matter. Various courts have confirmed the applicability of VAT on Banks/ NBFCs and the matter is now pending before the Supreme Court.

In the Model GST Law, if Banks/ NBFCs are treated as suppliers of such assets, the overall cost of operations for Banks/ NBFC’s would go up, as it is expected that the rate of GST would be higher than the present VAT rate.

**Input Tax Credit – Proportionate vis-à-vis fixed reversal ratio:-**
Presently, as per CENVAT Credit Rules, Banks/ NBFCs have options to reverse CENVAT credit either to the extent of 50%, or on proportionate basis to the extent of exempt turnover.

Under the Model GST Law, there is no such provision for availment of 50% credit. If such option is not available, then Banks/ NBFCs would be required to reverse input tax credit to the extent attributable to non-taxable supplies. Proportionate basis of reversal has scope for alternative interpretations and/ or verification from authorities. Hence, it should be represented that the option of reversal on the basis of a fixed ratio should also be available.

## Life Insurance:-

**Taxability of life insurance services:-**
Under the present regime, non-linked endowment insurance products are taxed at a lower service tax rate. The Model GST Law does not have a specific provision for such products.

Presently, the place of provision of services rendered by a life insurance company is determined on the basis of the location of the policy holder.

Under the Model GST Law, the place of supply for life insurance services is:
- in cases where services are provided to a registered person, location where such service receiver is registered;
- Where services are provided to other than registered persons, location of service receiver on the records of the service provider.

## Mutual Funds:-

**Services provided by mutual fund agents/distributors:-**

Presently, service tax is applicable on management fees charged to Mutual Fund (MF). Further, the asset management company (AMC) has centralised registration, and it avails credit of expenses incurred by branches all over the country, at its principal place of business.

Under the Model GST Law, there is no specific place of supply rule for the operations of the MF and the AMC. Hence, the supplies of MF and AMC shall be governed by the default rule, i.e. the place of supply would be the location of the service receiver.

Since under GST, there would be State-wise registrations, AMCs need to review their procurement models to ensure that there is no blockage of credit. Additionally, the Model GST Law allows transfer of accumulated input tax credit by way of input service distributor (ISD) mechanism.

## Stock broking:-

**Place of supply of stock broking services:-**

Under the present regime, stock broking services qualify as an 'intermediary' and accordingly, the place of provision of service is the location of the service provider. Hence, in case of FIIs/ FPIs, irrespective of where the customers are located, the place of provision of service is in India and liable to service tax.
The Model GST Law specifies the place of supply of services in case of stock broking services as:
- in cases where the services are linked to the account of the receiver, the location of the service receiver• on record of the service provider; and
- where the service is not linked to the account of the receiver, the location of the service provider

**Key Action points:-**
- Determine the place of supply, time of supply and GST impact for various insurance products
- Analyse the impact on ERP systems and other transaction processing systems
- Address of policyholders should be mapped to the transaction systems
- Key Points for Representation  Lower GST rate for insurance sector
- Special reduced rate of tax for endowment products
- Insurance agents should be taxed on forward charge basis, and not on reverse charge

## Conclusion:-

Currently the effective tax rate is 14 %, which is levied only on fee component (and not interest) of the transaction.

**Highlights:-**
- Under GST, effective tax rate on fee-based transactions is expected to increase to 18-20%.
- As the taxs on the input services will increase, operating expenses (comprising of rent, legal & professional fee, advertisement, insurance, telecommunication and other expenses) will also increase marginally.

**Impact:-**

With the implementation of GST a moderate increase in the cost of financial services such as loan processing fees, debit/credit card charges, insurance premiums, etc. is expected.

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To conclude, introduction of Model GST Law is a significant development. However, substantial work still needs to be done on the law as well as on the IT framework. Further, business needs to represent to the Government/ Empowered Committee to obtain clarifications/ reliefs and commence planning for GST transition.

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