Creating Foundations

Tax Alert

India: GST Rollout

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Frequently Asked Questions

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India will roll out the new **Goods and Services Tax** ("GST") - the largest tax reform since its independence - on **1 July 2017**.

If the Indian Government wants to grant both, enterprises and administration more time to adapt, GST may be introduced from **1 September 2017**. This is actually the last possible date, as on 16 September the window provided by the Indian constitution for introducing GST will close.

It is widely expected that all enterprises will benefit from the introduction of GST. The International Monetary Fund expects a strong positive effect on the already good growth projections of the Indian economy. However, the short deadline for the rollout will also present significant transitional challenges for all enterprises. At the same time, we recognize the first unresolved issues and problems arising with the GST.

What is the GST?

The GST is a new form of indirect tax which will subsume the current indirect taxes into a unified tax.

The old Indirect Tax regime in India was plagued by multiplicity of taxes resulting in tax cascading, input tax credit blockages and litigations on account of simultaneous levy of certain taxes. The taxes included Central Sales Tax and Value Added Tax on the sale of goods, Excise Duty on the manufacture of goods, Service Tax on the provision of services, Octroi taxes on the entry of goods within some cities limits and other local taxes. The GST will replace most of these taxes and will create a uniform tax system across the country. It will tax the additional value created at every stage of the supply chain and therefore, will be similar to the German Value Added Tax, which in principle only affects the final consumer.

Taxes to be replaced by the GST

The GST will replace the following indirect taxes:

Central Level Taxes	*State Level Taxes*
Central Excise Duty on manufacture of goods	**Value Added Tax/ Central Sales Tax** on sale of goods
Service Tax on provision of services	**Entry Taxes** on import of goods
Additional Customs Duty ("CVD") on imports	**Octroi/ Local Body Tax** on import of goods
Special Additional Customs Duty ("SAD") on imports	**Luxury Tax** mostly on hotels
Various Cesses such as Swachh Bharat Cess, Education Cess etc.	**Entertainment Tax** on events etc.
Additional Excise Duty on manufacture of specified goods	**Purchase Tax** on purchase from unregistered persons

Customs duty in the form of **Basic Customs Duty** ("BCD") on import of goods into India and **Stamp Duty** on immovable property and legal instruments will continue. GST will further not replace taxes on electricity, alcoholic liquor for human consumption and tobacco products.

Is the GST indeed a uniform tax?

Strictly spoken, it is not. The GST recognizes **all services**, that is, the supply of goods and the provision of services. This is a clear simplification compared with the current system. However, it will consist of **three components**:

> **Central GST („CGST")** - Tax collected by the Central Government
> **State GST („SGST")** - Tax collected by the State Governments
> **Integrated GST („IGST")** – Tax on inter-state supplies and imports collected by the Central Government

Which of these three taxes or a combination thereof will apply on a transaction will depend on the "place of supply". Supply of goods and services **within one federal state** will be subject to both CGST and SGST, whereas supply of goods and services **between two states** and imports **from abroad** will be subject to IGST *only*.

Place of Supply	Applicable Tax
Supplies within one Federal State	• CGST • SGST
Inter-state Supplies	• IGST
Import of Goods	• IGST • *BCD*
Import of Services	• IGST

In a summary, **the place of supply** for goods will be the place where the movement of goods terminates for delivery. For services, it will generally be the location of the service receiver. **Exports** of goods and services will be exempt from GST.

How high is the GST rate?

The standard rate of GST for most goods will be **28%** while some capital goods and services are to be taxed at **18%**. A goods tariff number (similar to the HS code) will be used to determine the classification for applicable GST rates.

For supplies *within* one federal state, the tax rate will be divided between CGST and SGST based on agreed proportion. In the case of inter-state supplies, the combined IGST rate will apply. The fact that both CGST and SGST will apply on supplies within a Federal State will not increase the applicable GST rate. The GST rate structure is as follows:

Supply Group	***IGST (in brackets CGST + SGST)***
Exports	*0%*
Important daily consumer goods	*5% (2.5% plus 2.5%)*
Preferential tax rate for subsidised industries	*12% (6% plus 6%)*
Capital Goods (standard rate 1)	*18% (9% plus 9%)*
All other goods (standard rate 2)	*28% (14% plus 14%)*

Is everything going to be more expensive in India?

No. Earlier, for example, the purchase of a product in many cases involved two taxes, Excise Duty on their manufacture and VAT on their sale. The GST will replace both these taxes. For example, in case of manufacture of an air condition, the Excise Duty of 12.5% and VAT of 13.5% was applicable resulting in an effective tax rate of 27.7%. After the rollout of the GST, the same will be 28%. For other goods, a downward adjustment takes place depending on their classification. However, the tax rate on services will increase from earlier 15% to 18%.

Is an input tax deduction possible?

Yes. Registered taxable persons will be able to deduct the GST paid on purchases as input tax from the GST payable on the taxable supplies subject to prescribed restrictions. To this extent, GST is comparable to the **German VAT system**. Thus, manufacturing companies, traders or service providers will be able to offset the GST paid for the purchase of goods or services against the GST calculated and collected from their customers. The GST will thus become a cost factor only in the hands of the end user.

However, due to the three-tier structure of the GST, the provisions relating to **input tax deduction will be more complex**. Input CGST will be deductible as tax credit from output CGST and IGST while input SGST paid will be deductible as tax credit from output SGST and IGST. Cross utilization between CGST and SGST will not be permitted. Input IGST will be deductible against all types of output GST, i.e. IGST, CGST and SGST.

CGST collected can be utilized against	***SGST collected can be utilized against***	***IGST collected can be utilized against***
		./. Input IGST
./. Input CGST	***./. Input SGST***	***./. Input CGST***
./. Input IGST	***./. Input IGST***	***./. Input SGST***

From this system, however, there should basically be no additional tax burden (due to the fact that CGST and SGST will always apply in parallel). However, SGST of State A cannot be credited against SGST of State B. In addition, even cross border tax credit of CGST is not accepted by the tax authorities, yet. The matter is currently (mid-June 2017) still debated.

The prerequisite for an input tax deduction is receipt of a correct invoice, actual receipt of goods or services and the timely submission of tax declarations ("GST returns"). While these conditions are not surprising, the GST laws also require **actual payment of the GST by the person issuing the invoice** for entitlement of input tax credit in the hands of the purchaser. If the issuer collects the GST but does not pay it, the purchaser will not be allowed to offset the GST paid as input tax. The digital

and automated financial management systems will recognize such cases. For companies, this means a **considerable economic risk**, which can only be covered by an increased controlling effort.

An example please!

A supplier in **Gujarat** sells air conditions for a price of INR 100 to a company in **Maharashtra**. The supplier will show on the invoice to the customer INR 100 plus IGST amounting to INR 28. The supplier can pay the IGST collected by utilizing input tax credits of SGST, CGST or IGST paid on his purchases. The customer in Maharashtra can claim IGST amounting to INR 28 as input tax credit.

If the transaction is executed **within Gujarat**, the supplier will record the value of INR 100 plus CGST amounting to INR 14 and SGST amounting to INR 14 on the invoice. The supplier can pay the CGST collected by utilizing input tax credits of CGST or IGST and the SGST collected by utilizing input tax credits of SGST or IGST. The customer in Delhi can claim CGST and SGST of INR 14 each as input tax credit.

Will input tax credits be refunded?

No. In general input tax credits **won't be refunded**. An exception applies to companies undertaking export of goods/ services and cases where credit has accumulated on account of rate of GST on inputs being higher than rate of GST on output supplies (for example, where supplies are subject to a GST rate of 18% while the purchases are subject to a GST rate of 28%). As a result, any unutilized input tax credits resulting due to situations apart from the above two cases, will accumulate in the books of accounts as in the previous CENVAT system.

Looking at it in detail, exporters may suffer from the fact that GST will curb upfront exemptions from duties and taxes (like under the current Advance Authorization scheme). Exporters will now first have to pay taxes and duties on their purchases and can apply for a refund only upon export. The timing difference can have a negative impact on their cash flow.

What actions are required by your Indian subsidiary?

The draft law provides for the **automatic transfer** of tax-registered companies **into the new system**. Existing **input tax credits** (CENVAT and VAT) should also get transferred subject to prescribed conditions. Transitional provisions are planned for pending tax litigations and other areas.

For transfer of registrations into the new system ("migration"), the companies are **still required to undertake certain procedures** before the prescribed timelines.

Indian companies must take urgent action. The required IT infrastructure needs to be created, accounting systems adapted; strategies for pricing and supply chains have to be developed. For several months now, we have seen Indian customers asking their suppliers to confirm in writing that they are **"GST-ready"**, have introduced a **"GST Taskforce"** or have made even further preparations. This is due to the fact that the customer can take GST as input tax credit only if their suppliers have paid the same to the Government.

Does the GST also affect foreign companies - without a presence in India?

Many foreign enterprises will enjoy lower costs of sales in India. Resulting **opportunities** should be seized. Current sales structures can be revised, prices renegotiated and sales agents may be replaces by reseller structures.

Generally speaking: Apart from that, the situation for foreign enterprises having no presence in India will largely stand unchanged. They will not have to report indirect taxes on their invoices under the GST. The customer will calculate and pay the applicable GST on the basis of the net invoice himself ("**reverse-charge procedure**"). He should not reduce the invoice amount by the GST paid.

Withholding tax is still levied on remuneration for services and royalties paid from India. However, such tax is the *income tax liability* of the foreign company in India and thus a completely different issue.

Our Comment

The new GST will **simplify** Indian indirect taxes to a great extent. Companies can again focus on making business instead of filling in forms and tax returns. Many procedures will go **online**, reducing the risk of corruption.

Unclear and heavily debated legal terms such as "manufacture", "sale" and "provision of service" will lose their relevance. This will also **reduce the issues of double taxation** under sectors like Information Technology Software and Construction Services.

The highly complex structure of the customs duties with different types of taxation and in each case, a different assessment basis will be removed. Under the GST regime, import of goods will attract Basic Customs Duty (BCD) and IGST making the structure simpler. The availability of Input Tax Credit of IGST to importing resellers will significantly improve the tax cost in the supply chain. The availability of input tax credit will also be beneficial for the service providers.

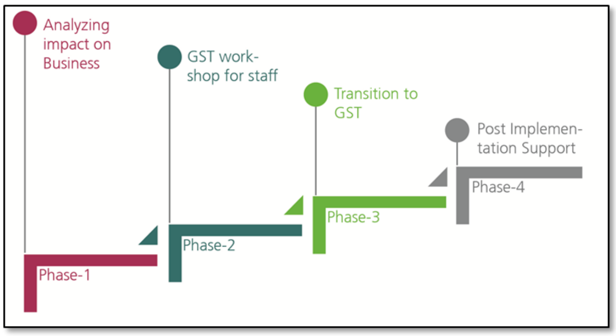
On the **downside**, the input tax credit will depend on the honesty of the suppliers' for payment of taxes. And, of course, the tight schedule up to the rollout of the GST is already a challenge, especially with unresolved issues under discussion. For service providers, the complexity of the documentation and number of tax returns will increase. For electricity producers including renewable energy project owners, additional tax costs arises as a result of non-subsuming of electricity duty.

India on its way to the GST rollout

Way forward

- Status check "migration" of the Indian company.
- Status check adapting accounting and IT structure. Status check training of the Indian employees. The aim is to be "GST ready" by 1 July 2017.
- Impact assessment on all transactions and pricing systems.
- Amending purchase and sales agreements.

Rödl & Partner has developed a four stages approach to support Indian companies to adapt to the new GST. It starts with analyzing the specific business impact followed by training in workshops, successful transition and post implementation support.



For a detailed description of our approach, please see:

- India Goods and Services Tax

Rödl & Partner

In 2007, Rödl & Partner established its own presence in India with today 3 offices located in Pune, Mumbai and Delhi, as well as 2 working points in the cities of Chennai (Tamil Nadu) and Bangalore (Karnataka) to meet the growing demand of quality services in the southern region of India. One more working point will follow in Ahmedabad (Gujarat) in 2017.

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