CHAPTER – 2

ORGANIZATION OVERVIEW

Area of Research

Indirect taxes, specifically service tax contributed by the financial services industry is a good portion of the total tax revenue collections of the Government.

Primarily the research deals with provisions of law relevant to financial services industry as they are today, the proposed framework for financial services industry in the GST set up in India and the impact of these on the industry.

The research paper is in relation to evaluation of the completeness of the provisions of law existing as on date which are a base for the proposed GST. The research also studies taxation of the financial services supply under the proposed GST and the impact of the CGST/SGST/IGST on the industry. The proposed framework implies massive changes in the IT, administration, compliance etc. for the financial services industry.

For this the organizations are restricted to banks, non banking financial companies or NBFCs and consultant organizations which deal primarily with these entities in the industry. This kind of niche selection is necessary since the subject matter of the research requires specialized knowledge and experience in the financial service field specifically banks, NBFC or consultants who deal with them as clients.

Thus the area of research is primarily organizations which deal in financial services. The tax teams in such organizations who are responsible for the interpretation of law provisions and rolling out circulars/instructions based on the same have been interviewed. The organizations are banks or NBFCs.
The research also covers various consulting organizations. These organizations generally have verticals within the organization or specialized teams who analyse provisions of law in relation to financial services industry and impact of proposed GST on the industry.

They are in constant touch with the tax teams of the entities in this industry and are advisors to them on a regular basis. Hence like the tax teams from the industry they are also aware of the current provisions impacting the industry as also the proposed GST framework and its expected impact on the industry.

Their views are generally more holistic for the industry, whereas the teams from industry hold views in line with their respective organizational policies.

Thus the paper studies the practical issues encountered by the banking industry under the current provisions of law and studies impact of the same in a GST scenario from both the industry and consultant perspective. The paper also covers the impact of proposed GST framework on banking.

**Products – Income Streams and their taxability**

To proceed with the research it is necessary to understand how the existing provisions of law impact the taxability of various incomes of the banks as on date.

For this procedure followed was first listing of the different income streams of the banks and then analysis of the same as to how they are treated under the current provisions of law.

Next, we need to analyze the grey areas where the industry is facing litigation or perceives litigation due to non clarity in law. This is highly relevant since in a GST regime it is recommended that provisions of law be reasonably clear on the applicability or otherwise of GST on the income.
Lastly these streams their taxability and the expectation from the proposed GST legislation are analyzed.

The banks generally have various streams of income. A review of the format of the financial statements of banks prepared as per the Banking Regulation Act, 1949 shows that the primary classification of these incomes is as under:

A. **Interest earned**

B. **Other income**

Of this the income is further broken down as under:

A. **Interest earned**
   
i. Interest /discount on advances/bills
   
ii. Income on investments
   
iii. Interest on balances with Reserve Bank of India and other interbank funds
   
iv. Others

B. **Other Income**
   
i. Commission, exchange and brokerage
   
ii. Profit on sale of investments (Less: loss on sale of investments)
iii. Profit on revaluation of investments (Less: loss on revaluation of investments)

iv. Profit on sale of land, buildings and other assets (Less: loss on sale of land, buildings and other assets)

v. Profit on exchange transactions (Less: loss on exchange transactions)

vi. Income earned by way of dividends, etc. from subsidiaries/companies and/or joint ventures abroad/ in India

vii. Miscellaneous income

Of the above streams of income the following are clearly covered under the negative list system of taxation:

**Interest earned** - Interest /discount on advances/bills and interest on balances with Reserve Bank of India and other interbank funds. These are covered directly under the negative list and are hence not liable to service tax. Presumably even under the GST framework, interest/discount income will be exempted or zero rated. Each of them has a further impact on the credit availability and cascading effect of taxes which is discussed in detail later.

However, income on investments and others covering miscellaneous interest income is covered in the CBEC education guide. Hence there is considerable litigation on the same.

Further income in the nature of profit/loss on sale of assets, revaluation of assets, investments, exchange transactions are all not liable to service tax by implication. These are all either pure transactions in money or goods both of which are excluded from definition of ‘service’ and are hence not liable to service tax. Discussions on the same with taxability are however discussed in the CBEC education guide and do not form a part of the law/rules. Dividends are also not liable to service tax by implication.
As regards incomes included in miscellaneous income and commission, exchange and brokerage needs to be analyzed. Generally all incomes included in these categories would be liable to service tax.

Thus as seen above, the current provisions are pretty clear on the liability to pay service on certain income streams but are grey in few areas which are interpreted as not liable to service tax. These grey areas should be preferably clarified by issuing rules/notifications before or with the introduction of GST to reduce litigation and confusion in implementation of GST.

The grey areas are in relation to areas like factoring interest income, invoice discounting income, CBLO interest income etc. which are incomes in the nature of interest/discount. However, since they are discussed in the CBEC guide and not covered in the main definition itself there is litigation around the same. These need to be explicitly taken out of the service tax net.

**Processes - Both taxable income streams and non taxable income streams**

Post identifying the groups of income of liable to service tax and not liable to service tax based on the current provisions of law, the process of recording the tax liability for income groups liable to service tax was studied. The assumption in the study being that the tax treatment of the said income streams post introduction of GST will not be drastically different.

This is also relevant to study the readiness of the industry in adapting to the GST framework.

The process was studied also to identify whether there are any inbuilt questions/checks in the existing system to identify the location of service provider, service recipient and/or location where service is originated/provided. This is particularly important in the GST scenario to split the GST liability for each taxable service into SGST, CGST and IGST depending on the place of supply of services.
For this it is important to identify the stage where the existing systems can capture location of service provider, recipient etc. Importance needs to be given to the fact and the point when this information is recorded in the system may be changed to adapt to the GST framework.

Similarly the income streams treated as non taxable need to be examined to study how the income is recorded, how the fact that it is not liable to service tax is identified and recorded, etc.

Based on the above, once the GST provisions or draft provisions are released it would be relatively easier for the industry to adapt their processes and systems to the law.

Emphasis needs to be laid on following questions for each income stream for ease of compliance to proposed GST. These questions are indicative and not exhaustive.

- Whether the income is liable to GST – For this the provisions of law need to be clear with minimum ambiguity.
- What is the nature of service
- Who is the recipient of the service
- Where is the service recipient located
- What is the status of the service recipient – i.e. is it a GST registered entity or not
- Which is the place from where the service is being provided

Once the above questions are answered (which can be done easily only if the provisions of law are clear) the system would need to be instructed on the treatment to be accorded and tax would need to be calculated.
Further, the process to collate data on the tax calculated would need to be tax wise. This implies that the process needs to collate CGST, SGST and IGST liability separately for each state.

Thus these are the broad norms for process to be adopted post GST introduction to calculate the output liability of GST.

A similar evaluation of process on the input service side would need to be done. Depending on the provisions of law introduced with GST, first eligibility of the input service to avail Cenvat credit would need to be determined.

Once that is done, point of time when Cenvat credit can be availed would have to be determined – i.e. when invoice is received, paid etc.

Post this the process will need to record the state in which the service provider is located and the branch of the service recipient is located. Again for identifying eligible input services, location of service recipient and provider, the provisions need to be explicit to avoid litigation.

Once the above is clear then, the input tax paid needs to be collated as CGST, SGST and IGST liability separately for each state.
Thus these are the broad norms for process to be adopted post GST introduction to calculate the input Cenvat credit to be availed under GST.

Separately, based on the provisions, process needs to be devised to calculate the output liability net of reversal (as the industry provides both taxable and exempt services) of CGST, SGST and IGST for every state.

Profiles

As mentioned above, the profiles of organizations, people and processes is very niche for this study. The subject matter is very specific to the financial services industry and has its unique
issues. Hence only related organizations and people are studied. Further processes have been studied and future changes are recommended based on practical compliance problems faced as on date and the expected compliances to be undertaken. The expected compliances are based on the general information on proposed provisions under GST floating in public domain.

The proposed provisions indicate that India will be adopting a dual GST model with CGST for Central Government and SGST for State Government. IGST is proposed for interstate transactions and taxability generally would follow destination principle. Thus the profile studied above, studies the existing income streams, their taxability and the changes required to comply in various states as against the current Centralized compliance. There is a presumption that the provisions in relation to taxability and ITC will not be hugely modified. However, the biggest challenge will be the states of compliance and the set offs of ITC against CGST, SGST and IGST liability. Thus the processes and policies need to match the challenge of the state wise compliance.

Thus the processes, organizations etc, are studied from the perspective of taxability, ITC availability, interstate compliances, challenges of dual GST mainly.