

# Transitional challenges under GST

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GST is a significant tax and game changing reform for the Indian economy. From an origin based taxation system to a destination based one, businesses have to overthrow the challenges to gain the benefits that the GST regime has proposed to extend. More importantly, the countenance of the transition involves many seen and unseen challenges having impact on the cash-flow, profitability, revenues and policy frame work which requires businesses to devise a process to embrace GST from the appointed day. This article briefly provides an insight into certain important matters involved in the transitional and other operational challenges.

## **1. Transitional provisions under the Revised Model GST Law November 2016 - challenges:**

The Revised Model GST Law, November 2016 (In short “Revised Model GST Law”) encompasses the transitional provisions which include CENVAT / Input Tax Credit carried forward into the GST regime, taxability of spill over transactions, issues relating to assessments and proceedings under the existing laws, refund claims etc. Transitional provisions provide impartial benefits to the taxable person migrating into GST coupled with certain restrictions which would throw up several challenges. Certain relevant ones are briefly explained here.

### **Credit of taxes under the current laws**

The Revised Model GST Law provides for carry forward of the credit of taxes paid under the current laws into GST regime. The transitional provisions (subject to certain restrictions), provides an opportunity to a registered taxable person to carry forward the unutilised credit (refund in case of CST paid), unavailed credit on capital goods, credit of inputs held in stock (as inventory, semi-finished goods or finished goods), credit relating to goods in transit, etc. While such enabling provisions can behold opportunities, there may arise challenges insofar as effective transition of unutilised credit of taxes paid under the current laws are concerned.

The registered taxable person is entitled to claim credit in a GST regime with reference to the credit as declared in the return filed for the period ending immediately prior to the appointed day. Such credit would include CENVAT credit of excise duty / service tax, value added taxes (in short ‘VAT’) and

entry tax (only in case the State entry tax law provides for such credits). The only condition for claiming of CENVAT credit is that such credit should be admissible under the GST laws. Whereas, carry forward of credit of tax relating to State VAT laws, additionally is coupled with the flexibility to accommodate revision of credit balance due to revision of returns under the current laws but not later than ninety days from the appointed date; and compliance with conditions (for issuance of statutory forms) if admitted to be kept up within the time provided for the same under the existing laws. Spill over transactions (beyond ninety days) will only enjoy the relief of refund but not transitional credit after such statutory forms have been submitted. The challenges prevail where statutory forms furnished previously are rejected in the course of assessment. Further, the manner of ascertaining the credit of tax attributable to the turnover where statutory forms have not been furnished is not specified and herein lies the risk of regressive steps by the tax administration.

The carry forward of taxes under the GST regime would be provisional, till the time the assessments under the existing laws are concluded on the taxable person. With such an uncertainty, each and every class of transaction would need to be critiqued to ascertain the admissibility of the credit. Subsequent disallowance may result in tax liability along with interest and penalty under the existing laws. Nevertheless, ascertaining the liability and the risk probability would be a challenging exercise to evaluate the quantum of credit to be carried forward under the GST regime.

The Revised Model GST Law does not provide for carry forward of CST paid on inter-State purchases. Therefore, the credit of inventory procured locally which is lying in stock as on the date immediately preceding the appointed day alone, can be carried forward. Hence, it is imperative to plan the pattern of procurement of goods under pre-GST regime as a part of the transition process in such a manner so that the inventory as at the end of the day, immediately preceding the appointed day comprises of the local purchases to gain maximum benefit, business considerations permitting.

The conditions specified with respect to claim of credit of inputs held in stock and those contained in semi-finished or finished goods by unregistered person under the existing laws, works contractor, first stage dealer or second stage dealer on the appointed day should be satisfied cumulatively. But a registered taxable person too, is not free from concerns that require him to comply with certain conditions viz., passing of the benefit by way of reduced price, correlating the goods lying in stock (including semi-finished and finished goods) with the tax invoices etc. While the conditions are specified, the details that would be required to justify the appropriate claim have not been specified. Therefore, the registered taxable person willing to avail the credit would be required to devise the formats and statements which would provide all the details / data in relation to conditions specified which may be required at the time of assessment under the GST regime to safeguard the claim of credit.

**Spill over transactions and taxability:**

The Revised Model GST Law contains provisions relating to return of goods under the GST regime which are sold, removed for job-work, further processing, testing etc. The return of goods within 6 months from the appointed day – exempt where exempted goods are returned; and refunded where duty / tax paid goods are returned. Such exemption and refund is allowed only if the returned goods are identifiable with the goods sent under the existing laws to the satisfaction of the Proper Officer. Accordingly, it is crucial that the supplier and recipient should forthwith record the details, such as - reference to sale invoices, description of goods, classification of goods, delivery challans, transit documents for onward and return movement, exemption notifications under the existing laws etc., to facilitate the identification of returned goods which seems to be challenging to a certain extent. Besides, the provision does not specify the time limit for processing the refund which would have an impact on the working capital, since existing laws provide for set-off of taxes paid on return of goods. Working capital will also be impacted in case refund is denied by the Proper Officer subsequent to refund of taxes by the registered taxable person to the person or dealer returning the goods. Therefore, the sale or purchase order / agreement to sell, executed should forthwith incorporate the situations where the recipient would be entitled to receive the refund of taxes on account of sales returns.

Insofar as return of goods removed for job-work or for further processing is concerned, challenges lie in ascertaining the classes of job-work / processes which would require more than 6 months and to identify returns thereafter, leading to recovery of input tax credit attributable to such goods. The issue arises where the supplier has agreements with the job-worker which provides for disposal of goods from job-workers premises. It must be noted that the Revised Model GST Law prescribes that the goods should be returned back to the 'same' factory. Such a restriction would require one to revisit the agreements with the job-worker and third party as well, with respect to goods removed in a pre-GST regime and expected to be returned under GST regime which requires steady planning for each removal. More specifically, this would have enormous impact over the arrangement where multiple job-workers are appointed for various process and goods are exchanged between such job-workers before they are returned to the Principal. However, the provisions relating to semi-finished goods or finished goods does not provide for such conditions relating to return of goods.

#### **Assessments, proceedings and consequential refund:**

It is specified that the pending refund claims and the refund applications filed after the appointed day shall be processed in terms of the provisions relating to the existing laws. Further, refund resulting out of appeal, assessment etc., would also be processed under the existing laws. The registered taxable person should adopt or take measures in situations where it is anticipated that the assessment or appeal or any other proceedings would result in refund. The provisions of existing law would be applicable insofar as processing the amount of refund and as such, the claims of credit should be eligible and supported with the detailed explanations and documents wherever required to minimise the probability

for rejection of refund. With such an uncertainty, it would, in certain cases, be appropriate to claim credit instead of maintaining the refund application. With the possible multiple options, it would become crucial for a detailed analysis to be made in the process of decision making.

### **Supply and taxability:**

Determining the time and place of supply of goods and / or services is one of the most important features in a GST regime. The IT platform to be created to determine the time and place of supply of goods and / or services is one of the most important transitional challenge. It needs a detailed analysis / study at the time of implementation. The challenge also lies in maintaining the data / details relating to the goods and services procured under the existing laws and the status of remittance of tax on each supply. The records should incorporate the details such as date of invoice, date of remittance of taxes, date of supply of goods / services, receipt of consideration, point of taxation etc., with related documents which would need to be corroborated to specifically ascertain as to whether the tax that is liable to be paid under the existing laws or under the GST Laws.

### **2. Other challenges:**

**Supply chain:** The supply chain and distribution, under the existing tax laws are designed to save the fiscal costs. The proposed transformation of taxation system from origin based to destination based taxation system is 'known to carry certain benefits to the supplier and recipient as well'. The supply chain management so designed to save fiscal costs under existing laws would no longer be beneficial to the supplier under GST regime in view of eligibility to claim credit of tax paid on inter-State inward supply. Therefore, the process of transition into a GST regime should assimilate the process of analysing the existing supply chain vis-à-vis the savings in commercial costs. The result of such analysis would undeniably require re-designing the entire supply chain management in view of tax planning and further, may compel to change existing warehousing / distribution locations with an outlay in capital investments.

**IT Infrastructure:** The IT infrastructure of the business needs a good bit of changes to identify every kind of supply which is liable to GST. The existing IT system should be transfigured to accommodate the accounts, statements and records viz., electronic credit ledger, electronic cash ledger, electronic tax liability register, outward supply register, inward supply register, tax invoice etc. The changes to IT system involves understanding the provisions of the Model GST Law with reference to the way the business is conducted, planning, analysis and requirements, system design, development, testing and implementation which is expected to be the most time-consuming process. The desired IT infrastructure should be in place as on the appointed day for effortless transitioning into GST.

**Policies and procedures:** As a part of transition process, business policies and frame work should be reconsidered to evaluate the impact of GST on each classes of transactions. Such evaluation should be



