

Issues in GST on Banking Sector

DISCLAIMER:

The views expressed in this article are of the author(s). The Institute of Chartered Accountants of India may not necessarily subscribe to the views expressed by the author(s).

The information cited in this article has been drawn from various sources. While every effort has been made to keep the information cited in this article error free, the Institute or any office of the same does not take the responsibility for any typographical or clerical error which may have crept in while compiling the information provided in this article.

Introduction:

The banking industry has come up with many ways of doing business where the transaction trails are very difficult to identify even for the banking employees. Banking transactions are routed through CBS (Core Banking System) where debits and credits of lakhs of transactions happen on real time basis. Banks deal with number of diversified partners right from the Government to the individual citizens. Further, the accounts are maintained at home branch whereas the services can be received by the customer at any other branch located anywhere in the world which is called as 'transacting branch'.

The GST impact needs to be analysed at each level of operations like cheque / Drafts/ cards/ issue process, ATM operations, credit wing, securities, letter of credit, net banking, cash backs and reward points, loans and advances, deposits, point of sale transactions, etc. This article lays down various issues that a banking sector may face in the GST regime. Various aspects discussed herewith would apply to all types of banks viz., Nationalised Banks, Private Banks, Public Banks, Co-operative Banks etc.

The major challenge for each bank would be to identify and understand its own nature of supplies, the transaction flow and then the situs and timing of taxation for each such supply, the valuation in absence of consideration and majorly identification of the location from where the service is rendered.

1) Rate of tax and valuation in case of repossessed assets:

When a bank re-possesses assets from a defaulter of loan & sales them, VAT is paid by the bank as a 'dealer' under state VAT laws in some States. The litigation continues as to whether,

the bank effects the sale of such assets or facilitates/ compels the sale of assets by the defaulting borrower or as the case may be, Bank has acted as an agent of the defaulting borrower to sale/dispose off the asset. Such sales are effected to realise the bad/sticky loans of such banks. In GST Law, if Banks are treated as suppliers of such assets, the recovery amount shall be reduced by GST amount, , as it is expected that the rate of GST would be higher than the present VAT rate. In case banks would take possession and control over under-constructed buildings if there is lapse in payment of instalments, in such a scenario building would be sold before the receipt of completion certificate or first occupancy. A suitable clarity has to be provided whether in this situation GST would be applicable or whether it will not be treated as supply by virtue of clause 5 of schedule 3 and not be taxable under GST since it is sale of immovable property.

One welcome measure is Valuation mechanism for repossessed assets from un-registered person is prescribed under proviso to sub rule 5 to rule 32 of GST rules. The purchase value of goods repossessed from a defaulting borrower, who is not registered, for the purpose of recovery of a loan or debt shall be deemed to be the purchase price of such goods by the defaulting borrower reduced by five percentage points for every quarter or part thereof, between the date of purchase and the date of disposal by the person making such repossession.

2) Reverse Charge on renting of immovable property under GST

Under Service tax regime banking company used to pay Service tax under Reverse Charge on advocate & Goods Transport services and others as given below:

- a) Services provided by way of sponsorship to any body corporate or partnership firm
- b) Services supplied by a director of a company
- c) Services supplied by a recovery agent to a banking company
- d) Supply of services by an author, music composer, photographer, artist

The above continues in the GST regime. Further, in GST law by notification no 03/2018 Central tax (Rate) dated 25th January 2018 has increased the scope of RCM to cover the Services supplied by the Central Government, State Government, Union territory or local authority by way of renting of immovable property to a registered person. Increase in list of services under reverse charge increases compliance burden on the banks. Further, in case of default by mistake, it shall increase costs in terms of interest and penalty.

3) GST on Import of Services

Notification no 10/2017 Integrated Tax (Rate) dated 28th June 2017 u/s 5(3) of IGST Act, requires payment under RCM for:

- i) Any service supplied by any person who is located in a non-taxable territory to any person other than non-taxable online recipient.

Thus, the import of services will fall under this category as supply of any service where the supplier is located outside India and the recipient is located in India, the place of supply of service will be in India.

It may be noted that, Import of services by an Indian branch from their overseas branch, in the course or furtherance of business, even if without consideration, will be a supply due to provision contained in Schedule I of the CGST Act, 2017.

4) Implication of GST on Merchant Discount Rate (MDR) Transactions

In Case of MDR transaction, bank's customer would visit a merchant store say a Mobile shop where he swipes his credit card of Bank 'X' in a Point of Sale (PoS) machine of Bank 'Y' used by the Mobile shop for Rs. 10,000/-. On real time basis, Bank Y's portal would send the info to National Payments Corporation of India (NPCI) and in turn NPCI checks with Bank 'X's portal for the availability of funds. If yes, the transaction would be successful. In this case, merchant is charged a fee of Rs.150/- out of which Bank 'X's share would be Rs.30/- for which this bank will debit the customer account by Rs. 10,000/- and transfer's Rs.9,970/- to NPCI and NPCI would in turn pass on the amount to Bank Y. Further Bank Y would credit the merchant's account by Rs. 9,850/- after deducting its charges of Rs.120/-. All the settlement happens through statement generated by NPCI and nowhere bills/invoices have been raised on any party.

Now, there are following three ways of looking at the transaction for discharging GST:

- a) Bank Y discharges GST on Rs.150/- and Bank Y charges nothing as GST has been already paid by Bank X on full value. Rs.30 is considered as share of revenue.
- b) Bank Y pays GST on Rs.120 and Bank X discharges liability on Rs.30 considering their respective income.
- c) Bank X raises bill on Bank Y for Rs.30 with GST. Then Bank Y avails the credit of the same and discharges GST on Rs.150/-. However, Bank Y may not be able to avail full ITC as it needs to reverse 50% of its credit as per Sec 17.

The second option would be ideal as the settlement been made on net basis and the parties shall discharge their liability on the respective income earned by them.

5) Implication of export realisation from foreign banks by Indian bank on behalf of its customers

Let us understand this transaction that the Indian bank has a customer named ABC Ltd who has exported goods to XYZ Ltd in Singapore worth USD 10 Lakh. ABC Ltd has asked Indian bank to do the necessary arrangement to get the Forex realisation. The XYZ Ltd on the other hand has account at Deutsche Bank in Singapore which transfers the amount to Citi Bank, New York after deducting its charge of USD 100. The Citi Bank, NY transfers the amount to City Bank India after deducting its charge of USD100 and then the Citi India would remit the amount to Indian Bank after deducting its charges of USD 50.

In the entire process, total 250 USD has been reduced from the realisation receivable by ABC Ltd and such charges are ultimately borne by ABC Ltd itself as per the terms of agreement.

In the instant case, if the terms of contract with customer XYZ Ltd provides for arrangement of 'Pure agent' of that customer, then the services received from foreign banks could be liable in the hands of customer ABC Ltd and not on account of Indian Bank. However, if the ABC Ltd and Indian bank has agreed to work on principal to principal basis where Indian bank does not merely get the reimbursement of the foreign bank's charges but charges a lump-sum to ABC which is over and above the actual charges paid to foreign banks, then the liability could be on the Indian bank as an importer of service under reverse charge mechanism qua the bank charges of foreign banks. The liability can be decided on case to case basis based on the terms of arrangement and the bank's role in the entire process.

6) Tax Invoice by Banking Company

Rule 47 of Central Tax provides time limit for issued of tax invoice, this rules has given relaxation to banking company, which can issue "Tax Invoice with period of 45 days" from date of supply of services instead of "30 days". Further Rule 54(2), provides further relaxation to Banking Company by providing an option to issue consolidated tax invoice or any other document in lieu of Tax Invoice at the end of the month for the supply of services made during a month.

Rule no 55 of Central Tax has also provide relaxation to banking companies, accordingly, instead ISD Invoice, banks can issue any document as ISD invoice and same may not be serially numbered. , thus it can be tax distribution advice.

Notification no 45/2017 & 55/2017 Central Tax, dated 13th Oct 2017 and 15th Nov 2017 respectively, has further amended Rule (1A) of 55 to provide that transfer of ITC to ISD by branch in same state can be through monthly consolidated invoice issued at the end of the month.

7) Situs of transaction in case of banking services:

Under GST Law the place of supply of services for banking and other financial services (BOFS) shall be the location of the recipient of services on the records of the supplier of services. Provided that if, the location of recipient of services is not on the records of the supplier, the place of supply shall be the location of the supplier of services.

However, what constitutes the ‘records of the supplier’ is not defined in the law leading to multiple interpretations as to whether it is to be understood as accounting records or customer records, vendor records and so on. Further, in some cases banks would have multiple addresses of the same customer in its records, this is possible as in case of a banking sector a customer would add multiple accounts within the same customer id and in which case only one address of the customer under whose address that customer id is registered would be reflected as the address on records.

However it is possible that the transaction is undertaken with the account holder within the same customer id but having a branch in different state. In such a situation, if strictly banks pay GST to the state based on the “address on record” then it may end up paying GST in a wrong state. Therefore, banks have to record the address of each account holders within the same customer id and GST needs to be charged on that account holder and accordingly tax also must be paid to that respective state government of the account holder and not the single address captured for the entire customer id. E.g. it is quite possible that bank issues ‘bank guarantee’ to be submitted to a local authority by a company. Now, if as per the bank’s records, address of the customer [as its HO] is mentioned/ maintained where such address is in the other state, wrong GST may get levied.

In this background, as which tax is applicable is based on Place of Supply, it is suggested to clarify in case of Banking Industry, which address should be considered i.e. Permanent Address / Correspondence Address / Head Office / Branch Office, etc as to determination of place of supply.

8) Inter-state supplies of goods or services (or both) between two branches of the same bank:

Unlike Service tax regime, transactions between Head-office and branches of different states are now taxable and transactions between the branches of same state are non-GST supply, which need to be accounted and reported under GST regime.

Inter-state supplies of goods or services (or both) between two branches of the same bank, located in two States, will attract IGST. Generally, in case of banks, purchasing of services are on centralised basis such as CBS Software, security software, AMC contracts for Computer Systems, ATM Machines, in such situation, there will accumulation of huge Input tax credit (ITC) of GST at head-office level, which needs distribution to each branches.

This distribution can be achieved either through obtaining “Input Service Distribution (ISD)” registration and thereafter distributing the accumulated ITC to other locations in proportion to their turnover

or

through raising the invoice for business support services by applying IGST on appropriate value.

Although, relief is provided in the valuation rules that in case of a transaction with distinct persons, value disclosed on the invoice shall be deemed to be taken as an open market value, however still valuation issues may creep as this rule does not apply if the receiving branch is not able to avail the full credit due to any reason whatsoever.

9) Reversal of proportionate Input Tax credit:

As per the provisions of the Service Tax Act, option has been given to bankers to reverse 50% of the CENVAT credit instead of reversing based on the input service partly attributable to the taxable supply and exempted supplies. Similar provision is also in place under GST law.

Section 17(4) CGST Act gives option for availing 50% of eligible ITC on monthly basis, thus taking it at par with service tax regime. Only change is with respect to supply transactions between branches/ head office, in such cases total credit is available.

In earlier regime, VAT/Excise paid on various procurement like stationary, maintenance items, etc were not eligible for the credit, now on common purchases bank will be eligible to avail 50% credit, thus again there is increase in overall available pull of eligible credit. This shall reduce cost of Banking Company.

In Service tax regime, as per Rule 6(3B) of CENVAT Credit Rules, 2004, an assessee in banking sector has to reverse 50% of the CENVAT Credit taken on monthly basis on inputs and input services. However, banks can take full credit on Capital goods unless the said capital goods are exclusively used for any exempted service.

However, section 17(4) of the GST law states that banks engaged in supplying services by way of accepting deposits, extending loans or advances have to reverse 50% of the eligible input tax credit on inputs, **capital goods** and input services.

However, in earlier regime banking companies were not able to claim VAT/Excise duty on purchases of goods, GST has provide the relief since all indirect taxes has been merged under GST, such credit is getting automatically available and thereby overall pull of eligible ITC will get increased.

10) Taxability of Interest:

Under Service tax regime, interest income and discount provided by the banks are covered under negative list, hence not taxable to service tax. Under GST, the term 'service' is defined in a wide manner to cover 'anything other than goods' which may cover interest as well.

However, Notification no 12/2017 Central Tax (Rate) dated 28th June 2017 has exempted services by way of—

- a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services);
- b) inter se sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers.

Thus the exemption as provided in Service tax regime is continued in GST Law.

12) Multiple registration requirement:

Under earlier regime, generally banks were register under centralized registrations scheme of Service Tax laws for all its branches. With the migration into GST, banking sector has under gone cumbersome activity of multiple states registration as operations of banks are spread across multiple states & union territory.

With this, banking sector is facing huge compliance burden, which requires, high level coordination and controls for compliance with GST Law. As compared to Service tax regime the compliance periodicity has been come down from 6 months to monthly basis and has become separate activity itself.

After introduction of GST, accounting, administration and financial records frame need overall re-engineering of process as banks are, now—required to maintain records for each state-wise separately to meet the requirement of filing of multiple state-wise returns and facing multiple audits and assessments.

13) Sales of Third Party Product:

Currently, in addition to banking operation, banking companies are also engaged into sale/ supply of third party products mainly mutual fund agency services and insurance agency services. Out of these services Insurance agency services are covered under reverse charge mechanism as notified vide notification no 13/2017 Central Tax (Rate) dated 28th June 2017. However, banks will have to disclose such business in GSTR3B and GSTR-1 return.

In case of income from mutual fund agency business, it will form outward supply services and bank will have to raise the invoice on Fund house by charging GST @ 18%.

Conclusion:

On overall basis, banking sector has been burdened with following due to implementation of GST Law:-

- i) Voluminous compliance due to change in frequency of periodical returns and multiple registration requirement.
- ii) Suitable & relevant maintenance of Books of Accounts, as GST requires state-wise consolidation of outward supply, ITC to be reported in GSTR return. Further in addition to reporting of taxable supply, a bank also has to maintain records of non-GST supply.

