

Draft representation paper on Goods and Service tax to be made to the Government of India by ICAI-Indirect tax committee

Indirect tax system in India is supposed to be one of the most complex systems in the world. Multiplicity of taxes, varying rates, costly compliance and lower revenue to the public exchequer are some of the important reasons which have compelled the administrators to bring in an effective tax system which can address such issues. Goods and Service tax (GST) which could be one of the biggest tax reforms in the history of independent India, is here at conceptual stage and once implemented is going to remain in India for years to come.

Being a proactive Institute, it has been always an endeavor of the ICAI to assist the country's Government, Regulators and citizens by communicating various concerns and suggestions. Due to its neutral image and credibility, it is privilege of this Institute that government has always been open to the suggestions of the ICAI in any tax related matters and tries to act upon the same to the maximum possible extent.

Having regard to the historical tax reform movement in the coming times, the Indirect Tax Committee has accepted the challenge of providing a platform to the trade and industry and enabling government to access to the thoughts, suggestions and concerns of India. To achieve this aim, the indirect tax committee, has assimilated certain common concerns which industry at large perceives on the verge of introduction this tax reform and compiled as a draft discussion paper for the perusal and comments of the general public.

The paper deals with certain common concerns as well as industry specific apprehensions for few Industries like Aluminum, Cement, Copper, Man Made Viscose Filament Yarn, NBFCs, Software and Telecom .You are invited to be the part of process of development of the law by providing your suggestions, comments, thoughts to the ICAI by mailing it to idthc@icai.org latest by 6th November, 2009.

So, if you want the law which is going to govern you for coming decades, to be in best possible form, act now and write to us immediately. We will make our every best effort to communicate it to proper levels at the law makers' end and ensure that it gets heard.

GST - Common concerns

1. Single rate:

- A single rate would help maintain simplicity and transparency by treating all goods and services as equal without giving special treatment to some 'special' goods and / or services.
- This will reduce litigation on classification issues.

2. Proper schedule entry / classification in case of multiple rates :

- Currently, as in the Sales tax / Commercial tax regime, there are multiple rates (0%, 2%, 4%, 12.5%, 20% and above) and the states have a free hand on increasing the rates by levying taxes under the guise of 'additional tax / surcharge/ cess'.
- Multiple taxes not only increase the compliance burden but also give rise to classification disputes.
- In case of multiple GST rates, there should not be more than 2 tax rates.
- Further, a proper entry / classification would lay such issues to rest. To minimize litigation,

3. Subsume all kinds of indirect taxes/cesses/duties:

- GST regime should subsume and bring under its umbrella other levies and tax regimes like CST, Entry tax, Service tax, Octroi (levied by local municipalities / municipal corporations), Entertainment tax, Stamp duty and their like.
- This would help in reducing the compliance requirements and result in savings in man hours required to be spent on the same.

4. Unambiguous definition of services / works contract supply of goods:

- Currently, works contract has to suffer VAT as well as Service tax.
- A simple and clear definition of services, works contract, supply of goods and taxable event will be of great help to trade and industry.
- Under GST transactions like works contract or indivisible contracts where service and goods values cannot be individually identified should bear the burden of tax only once.

5. Seamless and unrestrictive input tax credit:

- Currently, credit of input tax can be utilized only against the output tax paid under the same legislation. Further, it is restricted in most of legislations by one or another way.

- Under GST, a dealer should be able to avail and utilize input tax credit paid for all inputs, input services, all expenses involving supply of goods and services and adjust against their output GST liability or to claim refund of same.
6. Availability of input tax credit in case of interstate transactions:
- As on date credit of CST cannot be utilized against VAT or Service tax as it falls under a different tax regime.
 - Under the GST regime, dealers should be able to utilize credit on tax borne on interstate transactions or purchase of goods as well as services.
7. EPC/Multi State contracts:
- The present laws lack clarity in taxable event / applicability of GST and availability of input tax credit in case of EPC contracts / construction contracts
 - Under GST regime that there should be clarity with regard to taxable event, deductions available, availability of input tax credit or refund on such transactions.
8. Simplified refund procedure :
- Presently, the unutilized CENVAT credit is not available as refund to the manufacturers/service providers who are not exporting their goods/services. However, there are no such restrictions in the State VAT laws of most of the States.
 - Option of claiming refund should be given to all the businesses which are unable to utilize the credit of GST during their reporting period. Credits of taxes should be treated at par with taxes paid in excess. It is difficult to understand why the differential treatment under two different indirect laws.
 - Moreover, at present refunds claims are to be made separately under Service tax/Excise laws. Such claims are scrutinized in a manner which results into prolonged delays and undue harassment of the tax payers.
 - The refund claims should be credited to the claimant's bank account automatically within 15 days on receipt of return. In the cases of excess/fraudulent refund claims a penal interest may be charged to the assessee.
9. Advance ruling and DDQ :
- Presently, the Indian entities are not eligible to get advance rulings under Service tax/Central excise/Customs law.
 - If an Indian tax payer wants to know its tax liability in advance before starting a business, there is no such mechanism available, whereas, a person coming from a foreign country can have such advantage at a nominal cost. This is not the case for getting a DDQ in the case of State VAT.
 - It is a strong case under GST to allow all the tax payers to go for the advance ruling, Moreover, in order to enhance its utility, the advance ruling must be given within 3 months maximum from the date of filing application.

10. Part payment of demand for admission of appeal :

- The undue demand raised by reckless authorities compel tax payer to prefer an appeal against the vexatious order of such authorities. Many a times courts have highly condemned such behavior.
- Under the present tax system, tax payers have to pay such undue demands first to get the justice , which many a times deter the tax payer to prefer an appeal and surrender to high pitched demands in order to buy peace of mind.
- Moreover, even if the order is in favor of the assessee, it is almost impossible to get the refund from the department of pre-deposits.
- The assessee has to make a separate appeal for waiver of such predeposit , which consumes lot of precious time of courts and tax payers.
- In order to avoid such unjust situation, the condition of pre-payment of disputed tax liability should be done away with, for preferring an appeal.

11. Tax payment due dates:

- At present there are different incidences of attraction of different taxes and different due dates for making payment of the same.
- The due dates should be as per average market credit period or in the following month of receipt of payment.
- Alternatively, the tax payer should be allowed to choose suitable accounting system to discharge tax liability with suitable checks.
- Moreover, the due dates should be kept not before the second fortnight so as to enable the tax payers to compute their taxes accurately.

12. Simplified procedures / compliances for small dealers:

As a measure of taxpayer friendly exercise, simplified procedures should be introduced for small dealers like as under:

- Annual return to be filed only once in a financial year
- Reduced/ composition rate/amount: Either a lower composition rate may be introduced or a lump sum amount to avoid hassles of maintaining books of accounts
- Summary assessment : Assessment to be done without calling for books of account
- No visits by the departmental officers without specific information of evasion

13. Check posts:

- The concept of Check post introduced by various State governments has a substantial nuisance value without any corresponding benefits accruing to them.

- Enormous times gets wasted at check posts during the transit of goods from one place to the other which impacts heavily trade as well as consumers (in terms of higher prices) especially, in cases of perishable commodities.
- In the destination based tax system, the States will be more inclined to establish check posts at the entry points in the States. However, a better trade friendly system may be introduced in the place of Check posts.

14. Amendments in the law:

- At present a lot of changes are brought in the law/rate/procedures by way of circulars/notices/notifications/amendment Acts, etc almost on a daily basis. Moreover, a fair amount of ambiguities are created by bringing retrospective amendments during budget sessions.
- This results in uncertainties and chaos in business and industry. So much so as it acts as a deterrent to many foreign investors who do not want to risk their funds in no tranquil economies.

15. Advanced IT support:

It is essential to establish a robust and advanced IT infrastructure before GST is introduced to address the concerns of interstate transactions for cross verification transactions and minimal dependency on issuance / production of various declaration forms.

16. In case of any declaration forms, the coverage period should be quarterly or annual

GST Issues relating to few Industries

Aluminum Industry

Indian Scenario:

The total production of Primary Aluminium in India during 2008-09 was 13.48 lac Tonnes.

Issues in context of GST :

A. Electricity Duty

Smelting of Aluminium is a power intensive process. Electricity is the major energy input in aluminium production and is considered to be prime factor in determining economics of aluminium production

Nearly 15870 kwh of Electricity is consumed for producing per ton of aluminium metal.

Presently, set off of Electricity Duty is not available to the producers against their output liability.

The Electricity Duty translates to approx Rs. 3160 per MT of Aluminium's cost of production.

Proposal :

As is evident, Electricity Duty constitutes a significant component in the Cost of Production .

There is a strong case for subsuming Electricity Duty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

B. Royalty :

Aluminium manufacturing is mineral based . The major mineral Input is Bauxite which is converted to Alumina in Alumina Refinery and subsequently this Alumina is smelted into Aluminium metal.

Approx. 6 MT of Bauxite is required for production of 1 MT of Aluminium Metal.

Bauxite attracts levy of Royalty which is around Rs. 78 pmt .

Presently, set off of Royalty paid on Bauxite is not available to the producers against their output liability.

The Royalty translates to approx Rs 468 pmt of Aluminium's cost of production.

Alumina : Further, approx 11 lac Tonnes of Alumina, in 2008-09, was sold as such. The Alumina's cost of production has an inbuilt component of approx Rs 234 per MT, towards Royalty on Bauxite .

Proposal :

There is a strong case for subsuming Royalty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

Cement Industry

The Cement industry, being a core sector industry, producing the basic construction material essential for any construction activity, be it infrastructure, hospitals, housing, community development projects etc., plays a lead role in country's economic development and hence deserves due support from the Governments – central and states, for its healthy growth.

Proposed GST

Goods and Services Tax (GST) proposed from 1.4.2010 seeks to ensure simple and unambiguous tax laws, would replace taxes such as Octroi, Central Sales Tax, Turnover Tax, Tax on Consumption or Sale of Electricity, Tax on Transport of Goods and Services and eliminate cascading effects of multiple layers of taxation system presently in vogue. It should aim at facilitating seamless credit across the entire supply chain and across all states under a common tax base.

The taxes proposed to be subsumed in GST include –

(a) At the Central level:

Excise Duty, Additional Excise Duty, Service Tax, CVD, SAD and Surcharge.

(b) At the State level:

VAT, Entertainment Tax, Luxury Tax, Tax on Lottery, Entry Tax other than the local Government.

The following taxes are not proposed to be included in GST –

(i) At the Central level:

- (a) Specific cess,
- (b) Excise duty on tobacco products (in addition to GST).

(ii) At the State level:

- (a) Items containing alcohol,
- (b) Entertainment tax (local Bodies),
- (c) Entry Tax for local bodies,
- (d) Electricity duty.
- (e) Mining royalty or cess

Taxes paid by Cement Industry

Cement Industry today faces /pays a large number of central, state and local taxes, besides statutory duties and contributions under various statutory provisions and labour/ industrial laws. Some of the state / local taxes are –

- (a) Value added tax
- (b) Turnover tax
- (c) Octroi duty
- (d) Electricity consumption tax
- (e) Entry tax
- (f) Mining royalty/ cess

Issues in Cement Industry

It is expected that the transition to GST would impact the cement industry due to certain issues that may need due consideration by the Central Government, and Empowered Committee and suitably addressed. In case of the cement industry, the following issues need special mention-

- (a) Value Added Tax- VAT provisions of different State's VAT Acts have different definitions for Capital Goods and varied number of installments in which credit may be availed.

Now when the GST regime is proposed, and being deliberated upon, it is felt that the levy should be uniform and the rules/ regulations must be such that the inter - state trade and business can flow unhindered. Therefore, there should be uniformity in definition/treatment for GST across all the States.

- (b) Role of States -With proposed freedom to each State to legislate, levy and administer State GST (as announced by Finance Minister in Budget), there is a fear of it resulting in different treatment of what taxes may be subsumed in State GST. If the State Governments have still got the authority to legislate GST levy, then the very purpose of formulating GST Scheme will be defeated. It should be ensured that the State Governments should not have the authority to add any levies or surcharge beyond GST. There may be a common State GST for all States. Cement should be brought into the category of "Declared Goods", which will ensure the same VAT throughout the country as in case of Steel, presently at 4%.
- (c) Royalty/ Mining Cess- The list of taxes proposed to be subsumed in GST does not mention of Royalty/ Mining Cess. As is known, the cement industry depends heavily on limestone. It is the basic raw material and according to industry standards, about 1.5 tonnes of limestone is needed to produce 1 tonne of cement. Limestone is obtained by excavating from the mines leased out by the State Governments for which royalty is paid. There has been a recent upward revision of the Royalty on Limestone by 40% by the Ministry of Mines (up to Rs 65 per tonne)

all over the country which adds to the production cost of cement substantially . Royalty should be therefore, considered as a tax to be included in GST structure to receive credit .

- (d) Fuel and Power- Electricity Duty is imposed all over the country, both on grid supply and captive power generation. The cement industry is an energy intensive industry and all its operations, from raw materials preparations till cement grinding, require huge consumption of electric power. In India, most of the cement units have their installed captive power generation facilities due to erratic grid power supplies. Industry experience suggest that around 80- 90 units of electric power is needed to produce one tonne of cement. High fuel prices increase the cost of cement production. It is worth mentioning that power and fuel cost comprises more than 50 percent of the total cost of cement production. The cost being high, it is desirable that electricity duty should also be considered as a tax/ duty to be merged with GST and eligible to receive credit against GST.
- (e) Exemptions -Exemptions have been given in Excise Duty, Sales Tax and other duties, for promoting industries in difficult areas like north eastern states, hill areas like Uttarakhand, Himachal Pradesh, J&K or Kutch region of Gujarat State after earthquake, with certain time limit for industrialization of the States.

Under the GST regime, these incentives/exemptions should not be extended beyond the time limits fixed, as otherwise this will result in cross subsidization of these areas from not only industrially forward states but also from marginal states of industry and entrepreneurs of UP, Bihar, MP, Rajasthan etc.

Cement Industry - Indian Scenario:

The total installed capacity in India as of March 2009 was around 210 million tonnes With almost total capacity utilisation levels in the industry , India is the world's second largest producer of cement after China.

Issues in context of GST :

A. Electricity Duty

Nearly 85 kwh of Electricity is consumed for producing per ton of Cement.

Electricity attracts levy of Electricity Duty. Presently, set off of Electricity Duty is not available to the producers against their output liability.

The Electricity Duty translates to approx Rs. 30 per MT of Cement's cost of production.

Proposal :

As is evident, Electricity Duty constitutes a significant component in the Cost of Production .

There is a strong case for subsuming Electricity Duty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

B. Royalty :

Cement manufacturing is mineral based . The major mineral Input is Lime stone.

Approx. 1.3 MT of Limestone is required for production of 1 MT of Cement.

Limestone attracts levy of Royalty which is around Rs. 63 per MT . Presently, set off of Royalty paid on Limestone is not available to the producers against their output liability.

The Royalty translates to approx Rs 82 per MT of Cement's cost of production.

Proposal :

There is a strong case for subsuming Royalty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

Copper Industry

Indian Scenario:

The total production of Copper in India during 2008-09 was approx 7 lac Tonnes.

Issues in context of GST :

A. Electricity Duty

Nearly 1573 kwh of Electricity is consumed for producing per ton of copper cathode.

Presently, set off of Electricity Duty is not available to the producers against their output liability.

The Electricity Duty translates to approx Rs. 315 per MT of Copper's cost of production.

Proposal :

There is a strong case for subsuming Electricity Duty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

B. Royalty :

Approx. 3.5 MT of Copper Concentrate is required for production of 1 MT of Copper Metal.

Copper Conc. attracts levy of Royalty. In India, only Hindustan Copper Ltd. is surviving on indigenously mined copper concentrate while the other players depend on imported copper concentrate.

Presently, set off of Royalty paid on Copper Concentrate is not available to the producers against their output liability.

Proposal :

There is a strong case for subsuming Royalty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes.

Man Made Viscose Filament Yarn Sector

Indian Scenario:

The Textile sector is the largest employment provider, providing employment to about 91 million people i.e. 7.5% of the country's population. It also contributes to about 17% in export earnings and 4% in India's GDP.

Further, the Textile sector has an extensive value chain right from rural economy up to the final consumer through various stages of value additions in almost all parts of the country. Thus, it encounters all kind of Duties, Taxes, Cess, etc. and underlines the need of commonality between different States.

Within Textile sector, the 2 major sub-divisions i.e. Cotton and Man Made Fibre (MMF) needs to be dealt on an equitable basis for inclusive growth like in the rest of the world. At present, Cotton occupies 60% of the Textile sector in India and the balance 40% is by MMF. In contrast, Cotton occupies only 40% in the rest of the world and MMF occupies 60%.

Issues in context of GST :

A. Differential duty rates between Cotton and MMF

The growth of MMF in India has got stunted due to differential duty rates between Cotton and MMF at different stages of value chain.

Proposal :

In order to have a similar growth of MMF in India, as in the rest of the world, it is important that a uniform rate of GST is kept for all fibers i.e. Cotton and MMF.

B. Electricity Duty

Nearly 4102 kwh of Electricity is consumed for producing per ton of Viscose Filament Yarn. Presently, set off of Electricity Duty is not available to the producers against their output liability.

The Electricity Duty translates to approx Rs. 1641 per MT of VFY's cost of production.

Proposal :

There is a strong case for subsuming Electricity Duty in GST, for meeting the major objectives of GST namely avoiding cascading effect of taxes, simplification and avoiding multiplicity of taxes

NBFCs

I. Introduction

In the current Indian scenario, NBFCs are generally sophisticated financial operators and financial intermediaries, with a strong presence in the competitive fields of housing and vehicle financing, loans and investments, equipment leasing, etc. NBFCs are a segment of the financial sector which is fast emerging as an important participant in the Indian financial structure. The segment consists of a diverse group of companies/ institutions (not including commercial and co-operative banks) performing a variety of financial activities and operating at different levels of sophistication and scale.

Services and products offered by NBFCs (though in specific areas of the financial sectors) have been very diverse.

II. Definitions

To understand the characteristics of an NBFC, it is essential to examine the definitions provided under the relevant legislations.

NBFC has been defined under the Reserve Bank of India Act, 1934 ('RBI Act') (refer Annexure - A for the definition). The RBI definition of an NBFC covers a company that is a financial institution ('FI'), a company that is a non-banking institution ('NBI') receiving deposits or lending and any NBI as notified. Accordingly, for a company to be an NBFC

- it should qualify as FI which is in the businesses as covered in (i) to (vi) of Section 45-I(c) (provided in Annexure - B) of the RBI Act, or
- it should be an NBI receiving public deposits or lending in any manner, or
- any notified NBI.

Further, under the RBI Act, every non-banking financial company has to obtain registration with the RBI; and RBI is responsible for regulating and supervising the NBFC. As a regulating body, the RBI has been issuing directions to NBFCs from time to time. A direction which is of particular relevance to our discussion is the Acceptance of Public Deposits (Reserve Bank) Directions, 1998 ('APD Directions') which further defines¹ NBFC to mean 'only the non-banking institution which is a loan company or an investment company or an asset finance company or a mutual benefit financial company'.

¹ APD Directions [Para 2(1)(xi)]

Based on the above definition, NBFCs can be broadly divided into the following type of companies:

- Loan company
- Investment company
- Asset Finance company
- Mutual Benefit Financial Company

(Refer Annexure - C for definition)

Accordingly, all the activities performed by NBFCs would generally fall under the above categories. A single NBFC could have operations comprising one or more kinds of activities mentioned above.

III. Indirect tax implications

Generally, business activities of the NBFC sector are liable to Service Tax (at the Central level) and Value Added Tax (at the State level) or Central Sales Tax (Inter-State level).

Service tax

Service tax is levied on specified activities, qualifying as services, which are provided by NBFCs. Such activities are broadly covered under the service category of:

- banking and other financial services - which specifically identifies NBFCs as service providers and covers certain financial services provided by such entities
- business support services - covering certain incidental activities and support functions for business
- Other service categories which may specifically cover other financial activities performed by the companies as NBFCs

Value Added Tax/ Central Sales Tax

Value Added Tax is levied on sale of goods within a particular State, and is primarily on the transfer of property in such goods. Central Sales Tax is a similar tax (at a lower rate, subject to conditions) on inter-state sale of goods.

In the current context, Value Added Tax/ Central Sales Tax would be levied on the sales performed by the NBFCs which would primarily include sale of repossessed vehicles and other goods. Further, certain States may provide for an NBFC (having business operation in that State) to qualify as 'deemed dealer' thus requiring mandatory registration (for example Maharashtra Value Added Tax regulations which specifically covers 'financial institutions' under the 'deemed dealer' definition).

IV. Production of services

At this juncture, it is important to examine the 'factors of production' which determine the production mechanism. Historically, the factors of production have been determined to as the resources employed to produce [goods](#) and services. They facilitate production but do not become part of the product. These are generally classified into four major groups (a) Land (including all natural resources), (b) Labor (including all human resources), (c) Capital, and (d) Enterprise (which brings all the others together for production).

The role of an NBFC, in the overall production mechanism, can be split into two distinct parts; first is its actual active involvement in the production of financial services and second is its role as a provider of one of the factor of productions ie capital to the actual production of both goods and services.

In majority of cases, these roles are intrinsically intertwined with each other.

V. Different activities performed by NBFCs

As discussed earlier, NBFCs are licensed to perform various activities discussed in the paragraphs above. However, to list out the entire activities rendered by NBFCs would not be practicable. Accordingly, we can examine the activities from the context of their broad roles in the production mechanism discussed in the earlier paragraph and (to draw an inference) based on the RBI press releases/ directives. This provides us a starting point to determine the activities that can be performed by the NBFCs.

These activities can be broadly classified as fee-based and fund-based (non-fee based). Though the terms 'fee based' or 'fund-based' activities have not been specifically defined, an indicative list of the types of activities covered under these can be formulated from various press release/ directives issued by RBI.

Fee-based activities

From the perspective of NBFCs, based on the RBI press releases/ directives² and existing tax regulations, fee-based activities are activities which are the product of the (service) production mechanism itself. Typically these would include service products like advisory and consultancy, administration/ processing, providing additional/ optional facilities, transactions processing, etc. The NBFCs charge a fee/ or earn a commission for its service product based on the value addition in the process/ transaction.

Fund-based activities

Broadly, fund-based activities are where the NBFCs provide the factor of production ie capital. These activities are primarily in relation to capital or funds maintained by the NBFCs, which can be used by the NBFCs for the purpose of loaning, investment and asset financing, under the

² Press Note 12 (1999 Series)

NBFC license. Each of these activities allows the NBFC to utilize the capital/ funds directly to derive income/ returns from such capital/ funds.

Typical example would be loans for various purposes, financing, proprietor trading, securitization etc. The income/ return earned are in form of interest or trading profits.

VI. Current principles of taxation and tax implications - India

Currently, depending on the financial services provided by NBFCs, the indirect tax implications on the activities are provided below.

Activities	Broad IDT implications ³
Fee-based (including financial leasing, hire purchase)	Service Tax (Value Added Tax depending on the arrangement)
Fund-based (interest, trading profits, etc)	Non-taxable/ exempt
Disposal of repossessed vehicles or goods (sale)	Value Added Tax

VII. Global practices

European Union

The European Council provides directives to its European Union States for the purpose of harmonization of their tax regulations. Based on such directives, the State legislate their own laws which govern the tax regime.

In this regard, the European Union Value Added Tax directives provide the tax regime on supply of goods and services. Under these directives certain financial services are provided with an exemption from tax⁴. Some key exemptions are:

- granting and negotiation of credit
- transactions concerning deposits and current accounts payments
- debt transactions
- transactions in shares, debentures and other securities, etc

The principles of taxation followed under the directives are to tax production of goods and services without exception, and then to provide exemptions to specific goods/ services. This is true even in case of financial services, as seen above. Currently, very few financial services are being taxed, primarily in the nature of financial advisory services and consultancy services.

³ The tax implications are very broad and the activities have to be examined in close detail to determine taxability at a micro level

⁴ Article 135 (1)(b) to (g)

Canada

The Canadian GST is a multi-level value-added tax introduced in Canada on January 1, 1991. The tax is charged on the sale of all goods and services, except certain essentials. Specific tax-exempt items include residential rents, health and dental care, educational services, day-care services, legal aid services and financial services⁵.

VIII. Discussion points

Based on the GST models introduced in various Countries, and the budget speeches/ press releases by the Finance Ministry, the following should be examined.

Fee-based

Currently, the fee-based activities are being taxed under the indirect tax regulations in India, based on the nature of such activities. The principle of taxation being followed is that there is an effective value addition ie provision of services/ service product which occurs, and hence, such activities should be taxed.

Similarly, where such activities form a service product of the actual production process, and there is an element of value addition at this stage, these activities could be taxed under GST.

Fund-based activities

As discussed earlier, under the current indirect regime, these activities have not been brought into the purview of taxation, with special mention to exclusion of 'interest' under the Service Tax regulations.

With the advent of GST in the future, there has been a debate on whether such fund-based activity should be made liable to tax. In this regard, some of the points which can be considered for such a debate are discussed below.

1. Whether 'provision of capital' qualifies as service, having the essential nature of service?

The principle of a Value Added Tax on goods and services is to levy tax on the value added at each level of production of such goods and services. In the current scenario, the question arises whether activity of the NBFCs (providing capital) would constitute a 'service'.

The term 'provision of service' suggests an element of value addition, where the recipient receives a service product. However, a fund-based activity like lending/ financing in itself is not part of production of goods and services, but it is factor of production which is used to generate goods/ services.

⁵[http://en.allexperts.com/e/g/go/goods_and_services_tax_\(canada\).htm](http://en.allexperts.com/e/g/go/goods_and_services_tax_(canada).htm)

This debate is open-ended and requires analysis of various factors which interplay in this issue.

2. Whether capital constitutes an active or passive factor of production?

Capital in its traditional form has been the actual money which flows into the production mechanism. As such money is used for purchases/ investments which are then used for the actual production mechanism. Based on this characteristic of capital, some economists consider it to be a passive factor. In case tax is levied on lending/ financing activities, the consideration on which such tax would have to be imposed would be the interest component received by the service provider. Generally, the return on such activity is considered to be a compensation for the 'time value of money' (the return required for someone to be indifferent about whether to spend now or some time in the future). Thus, taxing the time value of money within the GST base would amount to tax on compensation or in other words tax on income.

Further, where capital is used in active income generation (as permitted under the NBFC license) through trading, securitization or investments, there is no element of service which is being rendered. These transactions are generally not subject to indirect taxes currently and in our view, should not be taxed under the proposed GST.

3. International practices

As discussed earlier, the principle of GST taxation followed by many countries, is to levy tax on all activities, and then to provide exemption to specific categories. This methodology seems to bring in an efficient taxing mechanism. For the scenario in India, this methodology may prove effective as the exemptions provided could be broad based and the financial sector itself will bring in a demarcation of the taxable and exempt business.

4. Sometimes Fee-based activities are linked with fund-based activity

As discussed earlier, fee based and fund based activities are sometimes intrinsically linked to each other. Bifurcation of these may not be possible at all times. Where a transaction contains both such activities (for example loan transaction which involves fee-based income ie processing fee and the fund-based income ie interest), the entire process would be considered as a single transaction. Further, where bifurcation is not possible, the entire transaction may be liable to tax on this ground, thus effectively taxing the fund-based activity.

An option that could be explored is to tax only pure fee-based activities like advisory and consultancy.

5. Impact on Indian economy

Levy of tax on the fund-based activities, would result in higher interest rates due to increase in cost of funds maintained by the NBFCs. This would in turn result in increase in cost of funds raised by any business.

This would impact a taxable business which can avail the input credits on such tax in terms of cash flow. Where the business is not able to avail credits, the entire tax would be a cost to its business. This, would in turn, affect margins of businesses, resulting in slowing growth of the business. This could have a significant impact on the economy as industrial growth may experience a slow down owing to increase in the cost of raw materials and high cost of funds. Further, given the current economic slow down, the impact of such a tax could be negative, at least in the short term.

For end consumers who avail financing facilities for personal consumption or for purchase of goods/ house, a taxable interest mean higher EMI payments, which, in turn, may be a deterring factor for consumers to buy consumer durables on installment payment basis. This could, in turn, affect consumer durable companies as well as financing companies.

Further, the impact would also be on loans/ credit facilities granted for the weaker section of the society. The aim of the Five Year Plans by the Indian Government which is generally focused on improvement of the weaker sections/ small scale industries/ agriculture/ mid-sized domestic industries/ domestic markets etc may be impacted.

A few examples of the impact provided was experienced in the past, where the RBI increased the Repo Rates (the rate at which the RBI lends to banks) and Reverse Repo Rates (RRR- the rate at which the RBI borrows from the banks) by 25 basis points each, the main objective of the hike was to contain inflationary pressures arising out of the fuel price hike⁶.

Further, where European Union and other countries are refraining from taxing certain parts of the financial sector, taxing the entire sector in India, could be detrimental to the economy.

Annexure

Definitions

A. Non-banking financial company

Section 45(l)(f) of Reserve Bank of India Act, 1934

"Non-banking financial company" means -

⁶http://statisticsofindia.com/tatasoi/images/des-views/rbi_raises_interest_rates.pdf

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme or arrangement or in any other manner or lending in any manner;
- (iii) such other non-banking institution or class of such institutions as the bank may with the previous approval of the Central Government and by notification in the Official Gazette specify.

B. Other relevant definitions

Section 45-I of the RBI Act, defines the following terms:

- (a) "business of a non-banking financial institution" means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f);
- (c) "financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities namely :
 - (i) the financing whether by way of making loans or advances or otherwise of any activity other than its own;
 - (ii) the acquisition of shares stock bonds debentures or securities issued by a government or local authority or other marketable securities of a like nature;
 - (iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act 1972 (26 of 1972);
 - (iv) the carrying on of any class of insurance business;
 - (v) managing conducting or supervising as foreman agent or in any other capacity of chits or kuries as defined in any law which is for the time being in force in any State or any business which is similar thereto;
 - (vi) collecting for any purpose or under any scheme or arrangement by whatever name called monies in lump sum or otherwise by way of subscriptions or by sale of units or other instruments or in any other manner and awarding prizes or gifts whether in cash or kind or disbursing monies in any other way to persons from whom monies are collected or to any other person,

but does not include any institution which carries on as its principal business -

- (a) agricultural operations; or

- (aa) industrial activity; or";
- (b) the purchase or sale of any goods (other than securities) or the providing of any services; or
- (c) the purchase construction or sale of immovable property so however that no portion of the income of the institution is derived from the financing of purchases constructions or sales of immovable property by other persons;

Explanation : For the purposes of this clause industrial activity means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act 1964 (18 of 1964).

- (e) "non-banking institution" means a company corporation or co-operative society.

C. Different types of NBFC as per Acceptance of Public Deposits (Reserve Bank) Directions, 1998

1. Loan Company means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company
2. Investment Company means any company which is a financial institution carrying on as its principal business the acquisition of securities
3. Asset Finance Company means any company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/ economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines
4. Mutual Benefit Financial Company means any company not notified under Section 620A of the Companies Act, 1956, and carrying on the business of a non-banking financial institution

Software Industry

1. Overview of software industries and recent trends

1.1 Background of IT sector in India

Information Technology (IT) industry in India is one of the fastest growing industries. Indian IT industry has built up valuable brand equity for itself in the global markets. IT industry in India comprises of software industry, information technology enabled services (ITES), and business process outsourcing (BPO) industry. India is considered as a pioneer in software development and a favorite destination for IT-enabled services. The IT / BPO / software industry in India has today become a growth engine for the economy, contributing substantially to increase in GDP, urban employment and exports and to achieve the vision of a “young and resilient” India.

1.2 Present scenario

Indian economy is booming rapidly due to fast growth of Indian Information Technology sector. According to the NASSCOM-Deloitte study, the IT/ITES industry's contribution to the country's GDP has increased to a share of 5.2 per cent in 2007, as against 1.2 per cent in 1998.

In an increasingly globalised world, significant complexity and uncertainty is getting attached to this unprecedented economic crisis. The Indian economy has also been impacted by the recessionary trends, with a slowdown in GDP growth to six per cent.

1.3 Performance of IT-BPO industry

The Indian IT-BPO industry is expected to achieve revenues of USD 71.7 billion in FY2009, with the IT software and services industry accounting for USD 60 billion of revenues. During this period, direct employment is expected to reach nearly 2.23 million, an addition of 226,000 employees, while indirect job creation is estimated to touch 8 million. In FY 1998, the contribution of IT sector to GDP was just 1.2 %, which is now expected to climb upto 5.8 % in FY 2009. Net value-added by this sector, to the economy, is expected to be at 3.5-4.1 per cent for FY2009. The sector's share of total Indian exports (merchandise plus services) has increased from less than 4 per cent in 1998 to almost 16 percent in 2008.

Exports market: The revenues from export of IT services are expected to cross USD 47.3 billion in FY2009, thus accounting for 66 percent of the total IT-BPO industry revenues.

Domestic market: Domestic IT-BPO revenues are expected to grow at almost 20 per cent to reach INR 1,113 billion in FY2009. The domestic BPO segment achieved growth of 40 percent during FY2008, and revenues of INR 88.7 million. The growth of IT sector

in domestic market will be driven by millions of SME's, apart from large / mid sized companies.

1.4 Challenges faced by software industry in recent times

The growth in IT sector is not seeing buoyancy now as compared to earlier years due to global economic crisis. The global crisis in the financial sector has highly affected Indian IT firms. Software exports grew from mere \$ 50 million in 1991 to \$ 40 billion in 2008, with compounded growth rate of 30 % over last three years. But due to economic meltdown, this growth is now reduced to 20 %.

1.5 Strengths of software industry

Invention of new technology is the need of hour and India has got the upper hand due to large number of software professional and experts. The potential of the youth needs to be harnessed to accelerate the economic growth rate by providing a suitable economic and tax environment.

1.6 Future outlook

The future of IT industry will depend on cost and availability of skilled man power. The focus on cost reduction is bound to increase, in view of the current recessionary environment.

Access to talent is likely to become more decisive as workforce demographics indicate a shortfall in the long term, in all major developed countries such as USA, UK, France, etc and some developing countries as well.

All the above reasons are bound to fuel global technology related spending on sourcing and Indian software / IT industry is bound to gain a large share out of international business pie. The industry anticipates that it can achieve an export target of USD 60-62 billion by FY 2011, employing 2.5-3 million professionals directly and contributing substantially to the socio-economic development of the country.

2. Overview of array of activities carried out by software industries

- Development of software – Packaged as well as Customized software
- High end designing
- Low end integration and coding
- Maintenance and repairs of software
- Web development / designing
- Software testing solutions
- Technical writing services
- Digitalization and Text management of software
- Computer based tutorials
- Business Process Outsourcing (BPO) services

- Consultancy services
- Systems integration, etc

3. Structure of Indirect Taxes in India

Presently, there are multiple Indirect Taxes being levied in India at different stages, under different circumstances and for different purposes.

A brief overview of some of important Indirect Taxes as under, would enable better understanding of the current Indirect Tax regime in India:

Particulars	Central level	State Level	City
Taxes applicable on movement of goods / provision of services	A. <u>On import of goods into India</u> • Basic Customs Duty • Countervailing Duty • Special Additional Duty • Customs Ed. Cess B. <u>On import of technology and know-how into India</u> • R & D cess C. <u>On export of certain goods</u> • Export duties D. <u>On import of certain services into India</u> • Service Tax	A. <u>On entry of specified goods in a particular State</u> • Entry Tax⁷	A. <u>On entry of goods in local jurisdictional authority</u> • Octroi
On transactions		A. <u>On sale of goods within same State</u> • Value Added Tax (VAT) B. <u>On sale of goods from one State to another</u> • Central Sales Tax (CST)	
On activity	A. <u>On manufacture of certain goods</u> • Central Excise Duty	A. <u>On manufacture of certain goods</u> • State Excise Duty B. <u>On carrying out</u>	

⁷ Apart from Entry Tax, State also levies Luxury Tax and Entertainment Tax on certain activities

Particulars	Central level	State Level	City
		<u>trade, profession and calling</u> • Profession Tax	
On documents		A. <u>On execution of certain documents</u> • Stamp duty	

The purpose of levy of tax, incidence and rate of tax (in certain cases) as applicable to software industries is discussed hereunder:

3.1 Customs Duty

Custom Duty is levied on goods imported into India. Customs Duty is levied primarily to protect domestic trade and industry, so as to make it competitive in the world market, besides to control the foreign exchange situation by restricting imports and promoting exports. The current effective rate of Customs duty applicable on import of softwares is 12.569% (CVD 8.24% + SAD 4%)⁸. Paper licenses are regarded as goods and chargeable to Customs Duty of 14.71% (BCD 10% + SAD 4% + Cus Ed.cess 3%).

3.2 Value Added Tax (VAT) / Central Sales Tax (CST)

When the software is sold within the same State it is liable to VAT @ 4%. When the software is sold from one State to another it is liable to CST @ 2% (against 'C' form) or rate of tax applicable in the buyer's state (without 'C' form). The same is also true when dealer trades in software products. In most of the states except states of Gujarat and Madhya Pradesh, the rate of VAT on software is 4%. "Transfer of right to use goods" is considered as sale under State VAT laws. The software developed whether standardized or customized is liable to VAT on supply of the same to the customer as the definition of "sale" is too wide.

3.3 Service Tax

Since 2008, supply / development of software or services in relation to development of software are brought into tax net. The rate of Service Tax at present is 10.30%. Following services provided by software industries to another are liable to Service Tax (covered under Section 65 (105) (zzzze) of Finance Act, 1994):

- (i) development of information technology software,
- (ii) study, analysis, design and programming of information technology software,
- (iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,

⁸ Basic Customs Duty is NIL, Customs Ed.cess is NIL vide Notification No. 69/2004 Cus dated 09.07.2004 read with Notification No. 28/2007 Cus dated 01.03.2007

- (iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software,
- (v) providing the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,
- (vi) providing the right to use information technology software supplied electronically”;

Information technology software related services are covered under other entries in Service Tax also as under:

- Consulting engineer service
- Business Auxiliary service
- Management, maintenance or repairs service
- Online information and data access service

It may be important to note that there is contradiction in provisions of Service Tax law. The definition of management, maintenance or repairs service clarifies that computer software is “goods” and information technology software is a “property”. Whereas the above discussed specific category considers software development and related aspects as “Service”.

3.4 Excise Duty

Excise Duty is applicable on manufacture of a product. The rate of Excise Duty applicable on standardized software is 8.24%. However, customized software is exempt from Excise Duty⁹.

3.5 Entry Tax

It is a tax levied on movement of goods from one state to another. However, same is applicable only in few States and rate for the same may vary from one state to another.

3.6 Octroi / Cess

⁹ Notification No. 6/2008 C.E dated 01.03.2008

It is a tax levied on entry of goods into territory of local authority. It is applicable only in few cities, many cities have replaced Octroi by levying account based Cess.

3.7 Stamp Duty

It is duty imposed at state level on certain legal instruments and commercial transactions. The rate of stamp duties varies from state to state. The assignment of copyrights of software may attract Stamp Duty in various states.

4. Issues faced by software industries in relation to Indirect Taxes at present

4.1 Multiple taxes

There are various taxes applicable to software industry on different aspects and values. Taxes like VAT, CST, Service Tax, Entry Tax, Customs Duty, Central Excise Duty, Education cesses, etc are few to name. It becomes quite difficult to operate under different tax statutes levying taxes on different aspects of a single activity. The cost of compliance and chances of lapses are bound to remain very high in such a scenario.

4.2 Overlapping of taxes

Apart from multiple taxes, the bigger issue is over lapping of indirect taxes on the same activity and value component. Some of such incidences have been discussed hereunder:

(a) Licensing of software

As observed from above, same transaction attracts many taxes. The activity of licensing of software being an activity of transferring right to use falls under the definition of sale and attracts VAT, further the same transaction is considered as service and attracts Service Tax under sub clause (v) and (vi) of Section 65 (105) (zzzze) of the Finance Act, 1994 if the right to use has been granted in case of software supplied electronically or if the right to use software has been provided electronically for commercial exploitation.

(b) Software development

VAT is applicable on both standardized and customized softwares. The same transaction also attracts Excise Duty in the case of manufacturing of standardized (off the shelf) software. Further, the activity of development of software and providing right to use software electronically also attracts Service Tax.

(c) Import of software

In case software is imported the same is also liable to Customs Duty apart from Service Tax under Service Tax (Import of Service Rules). Exemption has been granted to canned or packaged software to the extent of value which represents transfer of rights to use goods subject to certain conditions. However it appears to be an eyewash as, normally it is not a general trade practice to show separately the value towards right to use in invoice.

Courts have tried to resolve the confusion by holding that software whether customized or standardized are Goods¹⁰. Apex Court have laid down that there could not be two taxes on the same value¹¹ component of transaction. However due to existence of confusing provisions under different laws, the industry have taken a rather conservative view and preferred to pay multiple taxes like VAT and Service Tax both on the same value of sale of software. Retrospective amendments in law to overrule court judgments and absence of getting the Advance Rulings by resident persons have compelled industry stay away from sticking to a single tax (i.e VAT) on such transactions. Non availability of advance rulings to Indian residents software developers is one more reason of charging dual taxes on the transaction of sale / grant of license of software.

4.3 No seamless input credit mechanism across state / central taxes

At present, credit of tax paid at state level is not allowed to be set off against tax paid at Central level and vice versa. For e.g. VAT paid at the time of purchase of goods is not allowed to be set off against Service Tax / Excise Duty liability, This leads to increase in costs for the service provider / manufacturer which is ultimately passed on the consumer and it leads to increase in price of final product. The same is also true when Service Tax / Excise is paid at time of availment of input services / inputs which is not allowed as set off against VAT liability.

It would be pertinent to note that in UK VAT law, credit is granted of tax paid on goods against liability on services and vice versa. This leads to reduction in burden of taxes

¹⁰ In Tata Consultancy Services v. State of Andhra Pradesh (2005) 1 SCC 308 = 141 Taxman 132 = 271 ITR 401 = AIR 2005 SC 371 = 2004 AIR SCW 6583 = 137 STC 620 (SC 5 member Constitution bench), it has been held that canned software (i.e. computer software packages sold off the shelf) like Oracle, Lotus, Master-Key etc. are 'goods'.

In Associated Cement Companies Ltd. v. CC 2001(4) SCC 593 = 2001 AIR SCW 559 = AIR 2001 SC 862 = 124 STC 59 (SC 3 member bench), it was held that computer software is 'goods' even if it is copyrightable as intellectual property.

In State Bank of India v. Municipal Corporation 1997(3) Mh LJ 718 = AIR 1997 Bom 220, it was held that 'computer software' is 'appliance' of computer

In the case of Infosys Technologies Ltd. V. Commissioner of Commercial Taxes 2009 (233) ELT 56 (Mad.) it was held that even customized software constitutes goods.

¹¹ In case of BSNL V. Union of India 2006 (2) STR 161 (SC), it was held that when VAT is applicable, Service Tax cannot be made applicable.

In Imagic Creative Pvt. Ltd v. CCT (2008) 12 STT 392 = 12 VST 371 (SC), it has been held that Service Tax and VAT (sales tax) are mutually exclusive.

from point of view of the assessee and lower price of the ultimate product. Such cross activity credit has resulted the industry to boom.

4.4 Delay in getting refunds

The exporters of services are finding it hard to get refund from the department. There are around Rs. 2,000 crores refund claims pending with the department. Despite of Notifications, Circulars and Clarifications issued by the department where process of refund is made easier, exporters are not amused, they are of the view that it is very cumbersome and time consuming to get refund from the department. Such delay in huge amount of refunds has resulted in considerable amount of blockage of funds of the assessee and hampers their routine business. Further department does not give adequate interest for delay in refunding the amount.

Further department also raises queries and issues Show Cause Notices which may or may not be necessary to keep the refund application on hold. They also ask for additional documents / information which many times assessee finds it difficult to furnish. Such delay in furnishing documents, ultimately leads to rejection of the application.

5. Global Practices

Different countries follow different practice to tax transactions. For the sake of brevity only the following important points have been discussed hereunder:

European Union:

- UK VAT law provides exemption to goods and services imported from other country into UK.
- Normally there being a single tax of VAT, it helps avoiding the debate of goods vs. service and also multiple / double taxation on the same transaction.
- Unrestrictive set off credit is another virtue prevailing in EU which can be brought into the Indian GST.
- From 1.1.2010, EU is moving to a different place of supply rules and the country of consumption shall levy tax in most of the business to business transactions.

Canada :

- Similar to India, Canada has federal tax system, whereby both central and States levy GST on similar transaction.
- In Canada, different States levy tax at different rates.
- Customised software, packaged software and software on licence basis are being recognized differently and being taxed accordingly.

Australia:

- In Australia GST is levied on goods being sold and services supplied
- GST is leviable on almost all goods and services barring a few.
- Simple definitions of goods and services are provided.

6. Overview of Goods and Service Tax – One of the biggest tax reform in India

- Goods and Service Tax (GST) is a comprehensive value added tax on goods and services. It is considered to be one of the most important tax reforms in India.
- A dual system of GST is being proposed wherein Central Goods and Service Tax (CGST) and State Goods and Service Tax (SGST) will be levied on the taxable value of different transactions.
- It is proposed that CGST will be levied in lieu of Customs duty, Central Excise Duty and Service Tax at Central level and SGST will be levied in lieu of Value Added Tax (VAT), Central Sales Tax (CST), Entertainment tax and Luxury tax. There is still no clarity on Octroi, Lottery taxes, Electricity duty, State Excise which may be continued to be charged separately.
- The rates are yet to be made public but it is anticipated that there may not be more than 2 or 3 rates of GST. Import of goods / services are expected to be taxed whereas benefits are expected to be given to exporter of goods / services.
- With a single GST rate applicable to all goods and services across sectors, intuitive outcome is that the impact will be negative for sectors wherein the current tax rate is lower and positive for those wherein the current effective tax rates are higher than the likely GST rate. However, the negative impact could be muted to the extent of higher input tax credit available. Goods at macro level may remain unaffected on an overall basis, however the services may get hit due to double taxes under CGST and SGST (Presently services are only charged to Service Tax @ 10.30%).
- GST will be a destination based tax on consumption of goods and services which will be paradigm shift from existing origin based tax system under different Indirect Tax laws. It will subsume most indirect taxes (currently levied on both goods and services) under a single umbrella. Major taxes likely to be subsumed are CENVAT, VAT and Service Tax.
- Credit of CGST against liability of CGST would be allowed to be adjusted but not against SGST. Similarly SGST cannot be set off against CGST liability. Intra State SGST set off would be available. However, there are challenges in the case of set off of inter State SGST.

Some of the primary objectives of GST-based taxation are:

- o Ensuring availability of input credit across the value chain
- o Minimizing cascading effect of taxation
- o Simplification of tax administration and compliance
- o Harmonization of tax base, laws, and administration procedures across the country
- o Minimizing tax rate slabs to avoid classification issues
- o Prevention of unhealthy competition among States
- o Increasing the tax base and raising compliance

However, before it can be introduced Central and State government have to sort out issues like agreement on GST rates, constitutional amendments to empower state to collect taxes, etc.

7. Impact on software industries

Advantages

- Compliance cost and level:

Variety of numerous taxes shall get reduced to just one or two taxes which may result in decrease in compliance cost and increase in compliance level.

- No uncertainty in taxes

The taxes getting reduced to just one or two i.e CGST and SGST, there may not be any debate on concepts like whether software is “goods” or “service”. GST may also resolve confusion in the minds of the assessee, about which taxes to be paid and what credits to be availed for set off.

- Input credits

CGST and SGST both being levied the credit of taxes paid under respective tax laws can be availed seamlessly.

- Unutilized credits

Unutilized Cenvat credit is not allowed to a local player who does not have any exports. Under the proposed GST law the balance of unutilized Cenvat credit of GST at the month / year end is likely to be refunded irrespective of the fact whether such person is exporter or not.

Disadvantages

- Services

IT enabled services and the services in relation to software may become costlier in the hands of ultimate Indian customer as instead of one tax (Service Tax @ 10.30%), under GST regime there will be two taxes viz. CGST and SGST.

8. Suggestive representations of ICAI in relation to GST to the Government

In order to provide appropriate tax environment under new GST law, ICAI on behalf of the Software Industry would like to propose the following suggestions to be considered at the time of drafting / enacting the law:

Specific suggestions

A. Clarity on goods or service

Having regard to present provisions of Indirect Tax laws, it is not quite clear whether supply of software constitutes goods or service. Therefore care should be taken at drafting stage that there is no ambiguity and there is clear demarcation between Goods and Services.

We suggest that only packaged softwares (off the shelf) which are sold in form of CD's, licenses should be considered as goods. Further supply of Customized software should be considered as Service and not as goods. Software downloaded through internet should be regarded as service.

Normally it is understood that the rate of GST on goods and services are likely to remain same. However, place of supply rules may be different for Goods as well as Services. Therefore the clear distinction in the law itself is imperative.

B. Place of supply rules

A clear and unambiguous set of supply rules is the need of the hour in relation to transaction like E-Commerce, IT and IT enabled services. Because of its peculiar nature, the transactions of E-Commerce require special attention in the case of destination based tax.

Tax implications for software industries							
Sr. No	Activities	Description	Amount	Taxes applicable	Rate of tax (%)	Amount	Ref
1	Imports	Import of software components and software tools	50,000	Countervailing duty (CVD)	8.24	4,120	A
				Special Additional duty (SAD)	4.00	2,000	B
				Service Tax	10.30	5,150	C
		Import of CDs, floppy disks, etc	25,000				
				Basic Customs Duty	10.00	2,500	D
				Countervailing duty (CVD)	8.24	2,266	E
				Customs Ed. Cess	3.00	143	F
				Special Additional duty (SAD)	4.00	1,196	G
		Import of customized software / rights therein	100,000				
				Service Tax	10.30	10,300	H
				R & D cess	5.00	5,000	I
2	Local procurements	procurement of inputs from same state (4%)	50,000	VAT	4.00	2,000	J
				Octroi	2.00	1,000	K
		procurement of inputs from same state (12.50%)	25,000	VAT	12.50	3,125	L
				Octroi	2.00	500	M
		procurement of inputs from different state	25,000				
				CST (against C form)	2.00	500	N
				Entry Tax	2.00	500	O
		procurement of inputs from different state	25,000				
				CST (without C form)	4.00	1,000	P
				Entry Tax	2.00	500	Q

		procurement of services	50,000	Service Tax	10.30	5,150	R
		Cost of employees	100,000	No taxes	-	-	S
		Outsourcing	100,000	Service Tax	10.30	10,300	T
		Other input services (telephone, audit fees, etc)	150,000	Service Tax	10.30	15,450	U
		Cost of Electricity	50,000	Electricity duty	12.00	6,000	V
3	Development of software	Other input services where no Service Tax is charged	50,000		-	-	W
		Total	800,000			78,700	X
		Profit	200,000		-	-	
		Sale price of software	1,000,000		-	-	

Particulars			Model 1	Model 2	Model 3	Model 4	Model 5
	Indicative taxes applicable	Rate of tax	Amount	Amount	Amount	Amount	Amount
Sale price			1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
	Central Excise Duty	8.24	-	-		-	82,400
	VAT	4.00	40,000	40,000	40,000	-	40,000
	Service Tax	10.30	103,000	-	103,000	103,000	103,000
	Stamp duty	5.00		-	50,000	-	-
	Total		143,000	40,000	193,000	103,000	225,400
Less: Creditable taxes	Countervailing duty (CVD) (A+E)		6,386	-	6,386	6,386	6,386

	Special Additional duty (SAD) (B+G)		3,196	3,196	3,196	3,196	3,196
	Entry Tax (O+Q)		1,000	1,000	1,000	1,000	1,000
	Service Tax (C+H+R+T+U)		46,350	-	46,350	46,350	46,350
	VAT (J+L)		5,125	5,125	5,125	-	5,125
	Basic Customs duty		-	-	-	-	-
	Customs Ed. Cess		-	-	-	-	-
	R & D cess		-	-	-	-	-
	Octroi		-	-	-	-	-
	CST		-	-	-	-	-
	Electricity duty		-	-	-	-	-
	Total		62,057	9,321	62,057	56,932	62,057
	Net liability		80,943	30,679	130,943	46,068	163,343
	Non creditable taxes		16,643	69,379	16,643	21,768	16,643
	In terms of % of total cost		2.08	8.67	2.08	2.72	2.08

Model 1: Customized software is prepared at request of a client only license is passed to client
Model 2: Customized software is prepared on own without any order from client and subsequently sold as a ready made product
Model 3: Customized software is prepared on request of a client and copyrights are assigned on the completion of software development
Model 4: Customized software is prepared on request of a client from beginning itself and all copyrights belong to the client from the inception of the work
Model 5: Off the shelf software sold to client

Note: The views on applicable taxes are based on the general industry practise and are on conservative basis. It may be quite possible to argue on the basis of BSNL's judgment (2006 (2) STR 161 (SC)) that VAT and Service Tax cannot be levied on the same value of the transaction.

Turnover data for software industry

Sr. No	Financial year	Domestic turnover (INR)	Export turnover (Refer Note)
1	2009-10	650 to 670 billion (projected)	2160 to 2250 billion (projected)
2	2008-09	570 billion	2083.5 billion
3	2007-08	470 billion	1818 billion
4	2006-07	336 billion	1408.5 billion
5	2005-06	268 billion	1062 billion

Note: The figures of export turnover are available in \$ and for the purpose of comparison the same has been converted to INR at average rate of 1\$ = INR 45

Telecom Industry

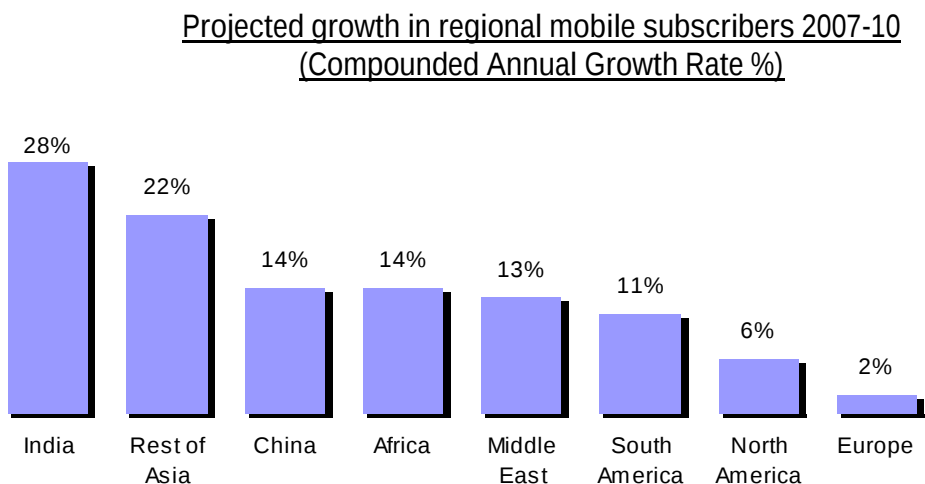
Indian Scenario:

As per TRAI, India's total telecom subscriber base touched nearly 430 million for the quarter ending March taking the teledensity up to 37 which included 391.76 million mobile lines and nearly 38 million fixed lines in service .

The Indian telecommunications industry is one of the fastest growing in the world and India is projected to become the second largest telecom market globally by 2010.

The last decade has witnessed exponential growth of telecom sector and number of mobile phone users has increased tremendously. The mobile teledensity coupled with its billion plus population offers immense growth potential for the telecom services sector in the coming years, when compared with growth expectations from most developed markets with tele-densities of over 70-80.

A comparative chart of India telecom growth potential with international markets is clipped below:



Source: Telecommunications Industry Association (TIA) Study, PwC Analysis

It can be inferred from the above graph that India has huge growth potential when compared with other countries. Further, the mobile subscriber base in India is expected to continue its strong growth pattern to reach over 625 million by 2010. This growth will continue to be contributed by mobile services segment which would be the preferred rollout medium even for rural markets which are expected to contribute to the majority of the next phase of growth in the country.

It is also a well recognized fact that telecom is a key contributor to economic growth.

A recent India Specific study released by Indian Council for Research on International Economic Relations (ICREIR), which tries to establish the impact of teledensity on the economic growth of various states of India, has established a significant positive correlation between increase in mobile penetration and growth in output. The study states that a 10% increase in mobile penetration delivers on an average 1.2% increase in output. One of the key findings of the ICRIER study is that the states of India having higher telecom penetration rate show a higher growth.

It is important to note that most of the countries treat telecom and broadband sector as a priority sector and recognize it as a driver of economic and social growth and accordingly levy the taxes in such a way that telecom sector can grow. For India, it becomes increasingly important to keep the rate of GST low on telecom sector which is currently suffering from multiple taxes.

Issues in context of GST :

A. GST rate on telecom services

The impressive growth of telecom sector has positively impacted service tax collection. Telecom services are now the single biggest contributor to service tax revenue.

India has a much higher incidence of Tax on telecom services when compared to other countries. A comparison of Taxes levied by different countries on telecom services is produced below (the below mentioned charges are % with respect to revenue after specified adjustments)

%age of Revenue	India	China	Malaysia	Sri Lanka
Service Tax, GST/VAT	10.30%	3%	5%	12%
License Fee (incl. USO)	6-10%	Nil	1.50% of gross adjusted revenue	0.3% Turnover + 1% of Capital invested
Spectrum Charges	2% to 6% + 3.95% of gross adjusted revenue for microwave access & backbone	~0.5 (China Mobile)	Nil	~1.1% of Turnover
Total Regulatory / tax Charges	22% to 30%	3.5%	6.50%	1.4% of turnover + 1% of invested capital + 12% VAT

Source: TRAI, Recommendations on Spectrum related issues

Thus the total incidence of taxes borne by the telecom sector ranges from 22% to 32% taking into account the service tax rate of 10%. While the proposed GST regime subsumes many indirect taxes levied by the Central and State Governments, it is a matter of fact that the GST regime does not propose to subsume any of the telecom specific charges/fees. Considering that most of the new subscribers will be added from “bottom of the pyramid” and rural areas it is imperative to keep costs low. The telecommunications services being a key catalyst for inclusive growth lends added importance attached to the sector and the high incidence of telecom specific fees, it becomes increasingly important to keep the rate of GST low on telecom services.

Proposal :

In view of the above, the GST incidence on telecom services be maintained at current level of Service Tax and should not be increased.

B. Double Taxation

The telecom sector suffers from the perils of double taxation in certain states, where VAT is levied in addition to service tax. The Karnataka High Court, in a ruling, decided that providing broadband connectivity amounts to 'sale of light energy', taxable under State VAT Act on the entire sale proceeds, despite being chargeable under service tax.

It is also imperative that the GST regime clarifies the Taxable event with respect to Pre-paid cards. Whether the taxable event is “Purchase” or “Use”

Proposal :

To avoid such multiplicity of taxes, the output of Telecom Sector should be classified as Services only.

It is the need of the hour that the GST regime clarifies that taxation of the ‘right to use’ transactions by treating these transactions as services and subjecting it to only Service GST at the Central level.

C. Treatment of cross-border taxation of telecom services

Services becoming subject to levy of State GST, in addition to Central GST (unlike subject exclusively to Central Levy under the existing regime), the determination of taxing jurisdiction under SGST attains considerable significance.

For example, if a person resident in Delhi travels to Mumbai and avails roaming services, there would arise an issue as to which state should get the revenue and how practical and administratively possible it would be to go by the destination principle.

Further, the telecom services are typically rendered by operators located centrally, but the services are spread across the country. GST being a destination based consumption tax,

determination of the State where consumption takes place will become a major area of concern/ litigation in case of cross border services.

Proposal :

Considering the need for keeping GST rate on telecom services low and considering the serious administrative/ implementation issues of taxing cross border services of this sector, it will be an administratively most appropriate and suitable option to subject the telecom service only to Central GST.

In the alternative, the place of supply rules for taxing services based on billing address of the service recipient (i.e. destination-based model should be adopted instead of place of effective use and enjoyment.

D. Set off of taxes paid on Infrastructure facilities

The telecom industry incurs huge cost in setting up and maintenance of infrastructure facilities like towers and telecommunications equipment which attracts VAT . The same is not available as set off against the service tax liability, thus leading to a cascading impact of taxation.

Proposal :

The taxes payable on Infrastructural facilities should be available for set off towards meeting the major objectives of GST namely avoiding cascading effect of taxes .

Also, since under the GST regime, un-utilized credits would be available as a refund to the assessee, the telecom service providers should be entitled to refund of Input State GST.

E. GST rate on mobile handsets

It may be relevant to note that the taxation on mobile phones today, for valid reasons, has been kept at a minimum as would be evident from the following table:

1	Basic Customs Duty on import of mobile phones in India	NIL
2	Additional Customs Duty in lieu of Excise (commonly known CVD) on import of mobile phones in India	1%
3	Additional Customs Duty in lieu of VAT (ADC) on import of mobile phone in India ADC is refundable on payment of VAT/ CST (subsequent sale)	4%
4	Excise Duty on manufacturing of mobile phones in India	NIL
5	National Calamity Contingent Duty (NCCD) of manufacture of mobile phones in India	1%
6	VAT on sale of mobile phones in most of the States in India	4%

The Central Government has developed the Zero duty policy dispensation after a great deal of thought and is foregoing both Customs duties and Excise Duties so as to curb the grey market

and enhance economic growth. Further, most of the States are levying 4% VAT on sale of mobile phones.

India is a very price sensitive market which is driven by affordability of service. To ensure further spread of service, especially to the rural areas, it is important to have as low entry barrier as possible.

While the proposed dual GST may revolutionize the indirect tax regime, the proposed high tax rates/ structure, incase made applicable to telecom industry, would be a serious detriment to its growth. Since, the GST rate across the world has been kept at a lower rate and certain countries have provided preferential treatment to telecom sector recognizing that it is important not to discriminate against a sector of the economy that is recognized as a driver of economic growth (e.g.Sri Lanka, while the Standard VAT rate is 12%, supply of cellular phones are exempt from levy of VAT), it is imperative that the overall rate of GST on mobile handsets does not exceed the present level.

Proposal :

The Central GST be exempt on mobile handsets as at present Excise Duty is not levied and State GST be levied at a lower rate of 4% so that the present tax incidence on the mobile handset is not enhanced.