

Decoding the draft GST law

Impact on Aviation sector

June 2016

India on the brink of GST

India finally seems to be on the cusp of implementing the much-awaited tax reform of Goods & Services Tax (GST). With the release of the draft Model GST Law on 14 June 2016, we crossed a major milestone and have certainly moved a step closer to GST.

It is noteworthy that the Model Law has been released on the final day of meeting of the Empowered Committee of the State Finance Ministers in Kolkata and amid a determined intent on the part of the Government to pass the Constitution (122nd Amendment) Bill in the forthcoming monsoon session of Parliament.

For the carriers, who hitherto have by and large been subject to a single service tax, and have the benefit of various duty exemptions on imports, moving to a state-level taxation structure would be fraught with complications. The decision to keep out aviation turbine fuel from the GST levy would no doubt add to this complication, possibly resulting in increased costs.

On the other hand, the GST is quite likely to give a fillip to the Maintenance, Repair & Overhaul (MRO) industry for two primary reasons. *First*, the Government's intent (as appearing in this Model Law) to tax maintenance activities undertaken outside India (on reverse charge) would nullify the tax arbitrage associated with undertaking repairs outside India (of course, business considerations would continue). *Second*, the treatment of works contracts as a 'service' under GST would bring certainty on taxability of maintenance activities and reduce the multiplicity of taxation.

In the ensuing paragraphs, we have sought to identify the key aspects of the Model Law as may be relevant for the Aviation Industry.

A. Carriers

1. Change in taxation structure requiring splitting up of fares

Currently, a ticket attracts service tax if the passengers embarks in India for the journey (irrespective of stopovers or return journey which may be outside India). This is explained by way of an example:

- In a Delhi-London-Delhi flight, the entire ticket attracts service tax (since the embarkation is in India) but a London-Delhi-London flight would not attract service tax.
- In a Delhi-Mumbai-Delhi flight, the entire ticket attracts service tax.

The Draft Model specifies that the single 'journey' would now be segregated into its constituent legs (separated by stopovers). Thus, a return journey would be treated as a separate journey (irrespective of the fact that a single ticket is issued).

Thus, in the aforesaid illustration, in the international journey, the Delhi-London leg would attract GST in Delhi. In the domestic journey, the Delhi-Mumbai leg would attract GST in Delhi, while the Mumbai-Delhi leg would attract GST in Mumbai.

This would require a realignment of the ticketing systems for all travel within, to and from India. This will also result in valuation issues, which we will discuss subsequently.

Key Action points

- Ticketing systems would need to be realigned.
- Analyse the impact of the change in the taxation structure *vis-à-vis* the current structure from a taxation, compliance and valuation perspective
- If required, represent for restoration of the structure for taxation of the entire journey based on place of embarkation

2. *Rate of tax – Possible increase in ticket prices*

Currently, air travel attracts service tax @ 6%¹ for economy travel and 9%² for non-economy travel. Though the GST rate has not been announced, the Chief Economic Advisor has suggested a rate of 17%/ 18%. A GST rate of 18% may lead to a 9% to 12% increase in the cost of air travel for passengers, thus hampering the growth of the industry³.

It may be relevant to note that the lower rate of service tax for air travel is subject to the carriers not availing credit of inputs, which primarily comprises the aviation turbine fuel (accounting for approx. 35% of the cost of the carriers). Under the GST also, the carriers would not be able to take credit on aviation turbine fuel (which would be kept outside the ambit of the GST). In such circumstances, it is imperative that the carriers ask for a lower rate of GST on passenger travel.

Further, the Model Law contains provisions for zero-rating on exported goods or services. However, the Model Law does not envisage zero-rating of international air travel.

Lastly, the Model Law is silent on whether the current service tax exemption on flights to/ from specified airports in the North East region would continue under the GST.

Key Action points

- Represent for a lower rate of GST on air travel
- Represent for zero-rating of international air travel
- Represent for GST exemption for travel to/ from specified airports in the North East region

3. *Where is the tax payable - Place of supply*

Determining where a service is rendered, or deemed to be rendered, has been a matter of constant debate and deliberation. The Model Law has provided specific guidelines for determining the 'place of supply' for aviation services.

Passenger travel

For passenger travel, the place of supply is segregated for B2B⁴ and B2C⁵ supplies:

- For B2B supplies, the place of supply would be the location of such registered person:

This is explained by way of an example. A carrier is registered in Delhi. A B2B passenger embarks from Delhi airport on the carrier. If the passenger is located in Delhi (generally determined by the GST registered premises of such passenger), the carrier would need to pay GST (CGST and SGST) in Delhi. If the passenger is located in Haryana, the carrier would need to pay IGST in Delhi.

- For B2C supplier, the place of supply would be the location where the passenger embarks for the journey

This is explained by way of an example. A carrier is registered in Delhi. A B2C passenger embarks from Delhi airport on the carrier. The carrier would need to pay GST (CGST and SGST) in Delhi irrespective of the location of the passenger.

What it means for the carrier is that for B2B supplies, the carrier would need to have invoice-wise details of services rendered to passengers so as to pass the input tax credit of the GST charged to such business entities. Given the ecosystem of the GST Network for passing credit, carriers would need to upload details of tickets sold to B2B customers on the GST Network. This is obviously a huge concern for the industry.

¹ Abatement of 60% on the value of the service

² Abatement of 40% on the value of the service

³ Though the carriers may get additional input tax credit under GST, such additional credit would not be substantial

⁴ Supplies to GST registered business customers who can take input tax credit

⁵ Supplies to non-business customers who do not take input tax credit

For intra-state B2C supplies, carriers are required to upload the consolidated supplies in the GST Network (and not invoice-wise details).

Further, specific place of supply rules have been promulgated for supply of goods or services on board aircraft, as follows:

- Goods supplied on board aircraft are deemed to be supplied at the location where the goods are taken on board;
- Services supplied on board aircraft are deemed to be supplied at the location of the first scheduled departure of the aircraft.

However, there are no specific provisions to determine the place of supply *vis-à-vis* ancillary services such as excess baggage, services rendered at the airports, ticket amendment/ cancellation, etc.

Key action points

- Align systems to record and keep track of B2B supplies on a ticket wise level
- Represent before the Government on the following:
 - Allow tickets to be treated as an invoice for GST (as is provided under the current regime)
 - Allow monthly consolidated invoices to be raised for B2B supplies and uploaded in the GST Network
 - Provide clear guidelines regarding the place of supply of ancillary charges (e.g., excess baggage, ticket amendments, etc.)
 - Exempt carriers from issuing invoices for sale of goods on-board aircraft

Transportation of cargo

Unlike the current regime, where the place of supply for transportation of cargo is the destination of the goods, under the Model Law, the place of supply is segregated for B2B and B2C supplies:

- For B2B supplies, the place of supply would be the location of such registered person.
- For B2C supplies, the place of supply would be where the goods are handed over for transportation.

This means that export cargo, which was hitherto not subject to service tax, would attract GST. Of course, the exporter may be able to claim a refund of the GST charged, but this could lead to cash flow issues.

Key Action points

- Review contracts with customers and renegotiate terms
- Represent for a GST exemption on export of cargo.

4. Issues around valuation to continue and may get aggravated

Another key concern for the carriers is the valuation of their service. At present, most carriers are litigating on the aspect of valuation of their service. It is the contention of the carriers that levies by Governments and airports on the passengers, which are collected by the carriers, do not form a part of revenue of the carriers, and should not be included in the service value. The current regime has a specific exemption for taxes levied by Governments on the passengers.

However, the Model Law stipulates that taxes, duties, fees and charges levied under any statute would be included in the value of the service. This seems to indicate that the intent of the Government is to tax all such duties and levies, irrespective of the fact that such levies may be by an overseas Government or airport.

This valuation issue gets further compounded by the fact that valuation provisions brought in for services/ goods in a similar manner as they exist under the current Customs law for import of goods.

Under these valuation provisions, the value can be rejected on the basis of different prices charged for contemporaneous services. Tickets sold at varying prices to customers may be rejected by the authorities and taxed at a higher price. The tax authorities also seem to have been given overarching powers to reject the value declared for the services. This specific provision can play mischief for the carriers.

Key Action points

- Represent for a GST exclusion for taxes, charges, duties levied by overseas Governments/ airports on the passengers
- Represent for dilution of the valuation provisions as they apply to services

5. Aircraft lease/ purchase now taxable

Currently, carriers are not required to pay any indirect taxes on lease of aircraft into India (as Customs duty on import of aircraft is exempt and the transaction is beyond the jurisdiction for levy of VAT). Only in case of a finance lease arrangement, service tax is applicable on 10% of the lease rentals.

Under the Model GST law, leasing of goods (i.e. aircraft) would qualify as a service and attract GST in the hands of the carrier, unless a specific exemption is provided. Though the carrier may eventually be able to take input tax credit of the GST paid, the upfront payment is likely to have huge cash flow implications.

Similarly, purchase of aircraft would qualify as a sale of goods and would attract GST in the hands of the carrier. Though the carrier may eventually be able to take input tax credit of the GST paid, the upfront payment is likely to have huge cash flow issues.

Key Action points

- Represent for a GST exemption on purchase/ import/ lease of aircraft

6. Increase in maintenance costs

Currently, maintenance and repair of aircraft undertaken outside India do not attract service tax in the hands of the recipient carrier. However, per the Model Law, services rendered by overseas MROs attract GST in the hands of the domestic carriers even if the services are performed outside India. Though the carrier should be entitled to input tax credit of the GST paid, it could impact cash flows.

Further, parts/ spares imported into India and supplied to the carrier (for use in repair/ maintenance of the aircraft) are currently exempt from levy of customs duties. However, as yet, no specific exemption has been envisaged under the GST on such supplies.

Key Action points

- Review vendor contracts for maintenance of aircraft and renegotiate terms
- Ascertain whether it may be beneficial to undertake certain maintenance activities in India
- Represent for a GST exemption on supply/ import of aircraft parts/ components

7. Payments to CRS companies – increase in costs

Currently, services rendered by overseas Computer Reservation Systems companies do not attract service tax since the place of supply for such services are deemed to be outside India.

However, per the Model Law, services rendered by overseas CRS companies attract GST tax in the hands of the domestic carriers. Though the carrier should be entitled to input tax credit of the GST paid, it could result in a cash flow issue.

Key Action points

- Review vendor contracts and renegotiate terms

B. Maintenance, repair and overhaul

1. Multiple taxation on maintenance activity removed

Currently, both VAT and Service tax is applicable on maintenance activities undertaken in India (referred to as 'works contract'). This has resulted in higher tax burden for the MROs.

The Model GST Law specifies that works contract (including any transfer of property in goods in the execution of such contract) would be taxed as a service. This is a welcome move and should provide certainty on taxability of the MRO sector.

The key implications for such change would include:

- Simplified treatment of works contract since there would be no multiplicity of taxes
- Ease in contract structuring - No requirement to split contracts into material and service portion as entire contract would be treated as service.
- Impact of rate to be analysed – since entire contract is to be treated as service, the tax incidence would need to be analysed *vis-à-vis* the current and GST regime. Removal of lower composition rates may entail higher output tax liability, and the same would depend on the valuation mechanism adopted for such contracts under GST law.

Key Action points

- Review existing contracts with customers to analyse impact of change in taxability of works contract – Tax clause and Change in law clause to be analysed
- Future contracts to be framed in light of proposed GST provisions for tax optimisation

2. Import of parts costlier in absence of duty exemption

Parts/ spares imported into India for use in repair/ maintenance of the aircraft are currently exempt from levy of customs duties. However, as yet, no specific exemption has been envisaged under the GST on such supplies.

Key Action points

- Represent for a GST exemption on procurement and supply of aircraft parts/ components

C. Airports

1. Place of supply

Under the current regime, services rendered by airports and other service providers at the airports (such as ground handling, cargo handling) are taxable based on the place of performance of the services, i.e. location of airport. Since the services are rendered in India, the activities attracted service tax irrespective of the fact that the services were rendered to carriers outside India.

Under the Model Law, the place of supply is segregated for B2B and B2C supplies:

- For B2B supplies, the place of supply would be the location of such registered person:
- For B2C supplies, the place of supply is:
 - the location of the service recipient where the address of the service recipient exists

- the location of the service provider, where the address of the service recipient does not exist

Thus, there exists a possibility to examine and identify the transactions (such as overflying charges) which should not attract GST, since the service recipient is located outside India.

Key Action points

- Review existing contracts with customers to analyse impact of change in taxability – Tax clause and Change in law clause to be analyzed
- Future contracts to be framed in light of proposed GST provisions for tax optimisation

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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