

Decoding the Model GST law

Impact on the Transport and Logistics sector

June 2016

India on the brink of GST

The current Indirect tax regime in India provides for a complex tax environment due to multiplicity of taxes, tax cascading and elaborate compliance obligations.

Under the proposed GST regime, all the key Indirect tax legislations would be subsumed (except for few taxes such as Stamp Duty), and hence it is expected that it would result in a simpler tax regime.

There has been significant progress on the GST front recently. With the release of the draft Model GST Law on 14 June 2016, a major milestone has been achieved and we have certainly moved a step closer to GST. It is expected that the Government would push for passage of the GST Constitution Amendment Bill during the upcoming Monsoon session. India finally seems to be on the cusp of implementing this much-awaited tax regime.

In the light of the above developments, Industry would now need to analyse the provisions of the draft law in detail and its impact on their business. This is essential to ensure that timely representations are made to the Government, as well as to identify key implementation requirements as part of the preparations for transition from the existing Indirect Tax regime to the GST regime.

For the Transport and Logistics Sector, in the medium to long term, GST will present a significant business opportunity as various Industries review their supply chain, in accordance with business considerations against tax considerations. Under the GST regime, industry players can opt to consolidate their warehouses and set up larger facilities, which will bring about supply chain efficiencies. However, there are still critical areas of clarity required that will have an impact on this sector, such as Place of Supply provisions, implementation of trade barriers in the form of check-post inspections, entry permits, etc. and taxability of e-commerce transactions. Additionally, an important impact for this sector would be migrating from a centralised registration and compliance methodology to a decentralised methodology.

In the ensuing paragraphs, we have sought to identify the key issues arising from the Model GST Law as may be relevant for the Transport and Logistics Industry.

1. Taxability of international freight

The Place of Supply provisions for transportation of goods has been defined as the location of the recipient, if the recipient is a registered person. If the recipient is un-registered, the place of supply is where the goods are handed over for transportation.

Under the present regime, for transportation of goods by vessel, services provided for the outbound movement of goods i.e. exports, have been zero rated, whereas services provided for the inbound movement of goods i.e. imports, are subject to Service Tax.

Further, for transportation of goods by air, the services provided, whether for outbound or inbound movement of goods, are exempt from Service Tax.

Based on the provisions of the Model GST Law, it appears that international freight (by air or sea) will be subject to GST, so long as the recipient is located in India. Though zero rated supplies have been defined in the law, the same has not been applied to international freight.

Key Action points

Representation should be made to zero rate international freight under GST, to keep the taxation of freight in line with global practices, with the objective of facilitating international trade.

Further, representation should also be made that ancillary services used for the export of goods be afforded the same treatment as international freight, i.e., zero rated. This will be in accordance with international practices adopted in Canada, Singapore, the UK and the EU, for the treatment of services ancillary to freight.

2. Input Tax Credit

Scope

The definition of capital goods has been drafted on the same lines as the existing CENVAT Credit Rules. Accordingly, Input Tax Credit only of those capital goods falling within specified Chapters to the Model GST Law will be allowed. Further, the definition of inputs and input services also provides for exclusions.

Therefore, it appears that even under GST, restrictions on Input Tax Credit will continue. Further, a nexus of goods and services received is also required to be established with outward supplies. Given this, the industry needs to represent for a broad-based credit mechanism.

Reconciliation of inward and outward supplies

In case there is a mismatch between the details of outward supplies uploaded on the GST Network by the vendors and the inward supplies uploaded by the recipient, the said mismatch would be communicated to the recipient.

If the mismatch is not rectified by the vendor in the month of communication, the recipient will be liable to pay the differential GST along with interest in the subsequent month. This provision places the liability for non-compliance on the recipient as against their vendors.

Credit of Aviation Turbine Fuel

Under the Model GST Law, Input Tax Credit on transportation fuels will not be permitted as the said products are proposed to be kept outside the purview of GST. This proposal will cause significant hardship to service providers engaged in the provision of transport of goods by air. This is also on account of the fact that such service providers are presently able to avail CENVAT Credit of Excise Duty paid on Aviation Turbine Fuel.

Additionally, in accordance with the Constitutional Amendment Bill, the provisions with respect to petroleum products provide that the GST Council will determine the approach and procedure for the inclusion of the said products under the GST regime. Given this, allowing credit of Aviation Turbine Fuel under the GST regime will not require an amendment in the Constitutional Amendment Bill.

Key Action points

The Industry should make a representation that credit be allowed for all capital goods, input services, inputs including Aviation Turbine Fuel for freighter planes, with the objective of lowering operational costs of transporters, and consequently enabling competitive pricing.

Changes in the mechanism of utilisation of Input Tax Credit will require re-alignment of the IT systems as well as effective vendor management. Businesses will need to ensure their vendors are compliant, by applying appropriate commercial safeguards such as release of payment only after the vendor has uploaded its invoice on the GSTN, or the possibility of vendor consolidations.

3. Place of Supply of Services provided to or received at multiple locations

The definition of 'location of supplier' and 'location of recipient provides' that the establishment most directly concerned with the supply shall be considered.

A company may receive a service in multiple establishments located in different states. In such situations, the Place of Supply provisions are unclear on which establishment would be regarded as the service provider/ receiver, in order to determine whether the supply is an intra-State or inter-State supply.

Key Action point

Industry Players should review the impact of Place of Supply provisions on procurements and outward supplies and ascertain the extent of credit utilisation and blockage, if any.

4. Point of taxation

The point of taxation for supply of goods or services among other criteria includes the date on which the recipient shows the receipt in his books of accounts. This would be a challenge to track on an ongoing basis.

Further, the Model GST law provides for reverse charge, among other criteria, the date of receipt of goods or services or the date of receipt of invoice as the point of taxation, whichever is earlier. It would be cumbersome to track these two dates.

The point of taxation, in general needs to be restricted to date of invoice or date of payment, whichever is earlier.

5. Classification of logistics services - bundled versus unbundled

In the transport and logistics industry, the services typically provided by a liner/ freight forwarder/ logistics service provider are transportation, cargo handling, customs clearance, terminal handling and warehousing. The services are subject to Service Tax at the rate of 15%. However, specified transportation services have been granted an abatement, such as transport of goods by vessel, rail and road.

On account of concessional rates of tax, the question which always arises is whether ancillary services can be construed as bundled with transportation services, so as to be eligible to avail the concessional rate.

The concept of bundled services has been defined under the present Indirect Tax regime. Similarly, the Model GST Law defines composite supplies. However this definition has not been incorporated in the provisions determining taxability or valuation. Therefore, presently, the taxation of bundled services is unclear.

6. Taxability of Services provided to overseas entities

Freight Forwarders and Courier service providers typically provide services as part of a global network in order to be able to provide last mile delivery for its customers in any country. The service providers therefore enter into network contracts whereby the Indian entity will provide services to its network entity with respect to the last mile delivery in India and *vice versa*.

Under the GST Model Law, services provided to a non-resident entity will be construed as services provided to a non-registered entity. Accordingly, the place of provision of service will be the location where the goods are handed over for transportation, which will be India. Hence, services provided to the non-resident entity will be subject to GST on the basis of goods being handed over in India and the recipient being non-registered. At the same time, services received from the non-resident entity will also be subject to GST under reverse charge on the basis of the recipient being in India.

It needs to be represented that the condition of registration needs to be waived in case of logistic services being provided to an overseas network entity, so as to qualify for export of services.

7. Lack of clarity on abatements

The Model GST Law does not presently provide for abatements. Given that petroleum products are outside the purview of GST, the same will constitute a significant cost, specifically to transportation services. Therefore, abatements should continue for transportation services of rail, vessel and road.

8. Lease of aircrafts

An operational lease of an aircraft under the present Indirect Tax regime is construed as goods, whereas under the Model GST Law, it will be construed as a service.

Presently, a carrier is not required to pay any indirect taxes on leasing an aircraft from an overseas entity. That is to say, aircrafts are not subject to Customs Duty (on account of an exemption) nor are the aircrafts subject to VAT (as the same are imported into India). However, under the Model GST Law, leasing an aircraft from a supplier located outside India, will be liable to tax as IGST on services under reverse charge.

Key Action point

The Transport and Logistics Industry should file a representation for the continuation of exemptions to import of aircrafts under the GST regime.

9. Valuation of service in case of related persons

Under the GST Model Law, the concept of valuation for services in related party transactions has been introduced. Therefore, for any services provided between group companies, such as agreements for logistics support between network entities, royalty for access to a global courier network, group company cost allocations, etc., it needs to be demonstrated that the transaction is at arm's-length. If this cannot be demonstrated, then the value shall be determined based on the GST Valuation Rules, i.e. based on services of like kind and quality, or the cost of providing the services, including profit.

These provisions may be challenging to implement with respect to cross-border transactions as it may not be feasible for the resident entity to obtain the value of similar services, or to provide the details of their cost of supply of services, to substantiate that the price is at arm's length.

The GST Valuation Rules do not prescribe the situations in which a price will not be considered to be at arm's length. Additionally, the Model GST Law provides that if there is a reason to doubt the accuracy of the transaction value declared by the supplier, then the authorities can determine the transaction value as per the GST Valuation Rules. Such an unfettered power to question the transaction value can lead to litigation.

10. e-Commerce

Presently, certain VAT authorities are seeking to demand VAT from courier service providers engaged in the delivery of cash on delivery (COD) shipments. This demand is based on the premise that the courier service provider acts as an agent of the e-Commerce vendor to effect sales in the state.

Clarity is required under the Model GST Law to ascertain the liability for the payment of GST on e-Commerce transactions.

11. Input Service Distributor

The Model GST Law provides for the distribution of IGST/ CGST/ SGST. This is a welcome measure. The distribution of SGST as IGST needs to be clarified as the GST framework does not contemplate utilisation of SGST of one state against SGST of another state.

12. Waybills and check-post related compliances

There is no clarity as to whether the present system of waybills and check-posts would continue. The Model GST Law grants power to the Government to prescribe documents for consignment of goods exceeding INR 50,000 in value. In the light of these provisions, it is important that the Transportation and Logistics Industry represent for the removal of waybills and check-posts related compliances, with the objective of optimisation of delivery schedules, lowering operational costs, and consequently enabling competitive pricing.

Lets talk

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

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