

Decoding the Model GST law

Impact on Telecom Companies

June 2016

India on the brink of GST

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 crossed.

Industry would now need to analyse the provisions of the draft law in detail. 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 GST regime.

In the ensuing paragraphs, we have sought to identify the key aspects of the Model GST Law as may be relevant for the Telecom Companies (telcos).

1. Change in the system of taxation

Under the current law, selling agents or distributors of SIM or Recharge Coupon Vouchers (RCVs) are exempt from Service tax. The liability to pay Service tax on the Maximum Retail Price (MRP) (which includes the agent's/ distributor's margin) is on the telco.

As the Model GST law currently reads, in the absence of an MRP-based valuation for the telcos and specific exemption to the distributors, it appears that each leg of the sale of SIMs/ RCVs would be subject to GST. This would mean that the distributors and all retailers in the supply chain would get taxed.

Further, those retailers who are below the threshold limit would not be subject to GST. As a result, the retailer's margin could be outside the GST ambit, thus leaving a small area of play for price arbitrage.

The Model Law has provided specific guidelines for determining the 'place of supply' for telcos, as follows:

- For fixed line, leased circuits, internet leased circuit, cable or dish antenna, the place of supply is where the line, circuit or cable connection is installed for receipt of services;
- For post-paid mobile or internet services, the place of supply is the billing address of the subscriber;
- For prepaid mobile or internet services, the place of supply is the location where the pre-payment is received, or the voucher sold. However, if the recharge is made through internet banking/ electronic mode of payment, the place of supply is the location of the service recipient on the record of the supplier.

For the telcos, this would require a realignment of the systems to account for the state-level taxation as well as the change in valuation. Further, issues such as determining the place of supply for leased lines connecting various offices, determining the location of service recipient in case of internet banking, etc., still need to be addressed. In case of leased lines installed between locations in two states, obviously the place of supply cannot be where the line is installed, since the line would be installed in two states. Therefore, telcos would need to convey their viewpoint on amendments that need to be made to the place of supply provisions as well as monitor any amendments to the provisions so that they can prepare for implementation under GST as per the amended provisions.

Also, with the diversification of the operations (such as introduction of mobile wallets), it would be important for telcos to examine each nature of transaction being undertaken to evaluate the impact of the Model GST law on such transactions.

Key Action points

- Systems need to be realigned for the change in the system of taxation; and
- Examine different nature of transactions being undertaken to assess the impact.

2. No transition provisions regarding availment of deferred CENVAT credit relating to one time charges paid for assignment of spectrum rights

A telco to which spectrum rights have been assigned can avail CENVAT credit of one time charges paid for such assignment equally over a period of three years. Considering the same, there could be a possibility that the entire CENVAT credit relating to such charges paid may not have been availed by a telco prior to the date of introduction of GST.

Currently, the Model GST law does not envisage any mechanism for transition/ carry forward of the CENVAT credit relating to such spectrum charges, which may have been deferred in terms of the CENVAT credit law and had not been availed prior to the coming into force of GST. Under GST, an adequate transition mechanism is critical to save the telcos against lapse of CENVAT credit relating to spectrum charges which was not availed prior to the introduction of GST.

Key Action points

- Advocacy with the Government to ensure that the issue of transition/ carry forward of CENVAT credit relating to spectrum fee is adequately addressed.

3. Clarity on telcos's eligibility to claim credit relating to passive infrastructure (towers, shelters etc.) still awaited

Currently, the telcos are in litigation with the service tax authorities regarding eligibility to claim CENVAT credit of materials used for construction of towers, shelters etc. Though the issue is currently pending before the Hon'ble Supreme Court and clarity is expected once the Court disposes of the matter, the industry was expecting that the issue would be specifically addressed under the GST regime.

However, under the Model GST law, a specific restriction has been provided for input tax credit of goods and services used for construction of immovable property.

Key Action points

- Advocacy with the Government to specifically enable telcos to claim input tax credit relating to towers/ shelters etc.

4. Tax on free of charge (FOC) supplies (including goods used for marketing and promotion)

Telcos generally supply marketing and promotional material to distributors/ agents on FOC basis. Under the current law, since there is no flow of consideration from the distributor/ agent to the telco, the transaction is not liable to tax as sale of goods.

However, under the Model GST law, even supplies made by one taxable person to another taxable person without consideration would attract GST. Consequently, telcos could be required to discharge GST liability on such FOC supplies.

Though, the distributors/ agents may be eligible to claim input tax credit of GST charged on such supplies, this can result in higher cash flow requirements for the telcos.

Key Action points

- Engage in discussion with distributors and assess the need to incorporate related aspects in the contractual arrangements; and
- Evaluate the estimated cash flow requirements.

5. Transfer of input tax credit from one State to another

The Model GST law envisages an Input Service Distributor (ISD) mechanism through which input tax credit of CGST, SGST and IGST may be distributed by one location of a supplier to a location (having same PAN) in another State.

The input tax credit can be distributed on a *pro rata* basis (depending upon the turnover) amongst locations to which the input service is attributable.

Therefore, if the input tax credit available to a telco exceeds its output liability in a particular State, such telco can distribute the accumulated input tax credit to its other locations and mitigate cost on account of loss of input tax credit.

Key Action points

- Identify possible States and transactions which can lead to accumulation of input tax credit for common services and evaluate possibility of distributing the same using the ISD mechanism. This is a beneficial provision under the Model GST law. Telcos should monitor future amendments to the GST law to be alert to any dilution or other adverse developments with respect to this provision.

6. No provision for transition of input tax credit relating to goods purchased

- Under the current regime, telcos are not eligible to avail credit of the tax (VAT/ CST) paid on purchase of goods. However, under the GST regime, telcos would be allowed to avail such input tax credit for utilisation against output GST liability.
- Currently, there is no specific transition provision under the Model GST law which permits a telco to carry forward such taxes paid under the present regime for utilisation against GST liability.
- Unless a specific provision enabling telcos to avail such input tax credit is provided under law, telcos may evaluate the timing of capital procurements under the current regime.

Key Action points

- Evaluate need for deferment of high value purchases planned close to the date of introduction of GST;
- Representation may be filed to include specific provision to allow credit of stock in hand for service provider as well as traders.

7. Double taxation on account of free supplies to service provider

- As per the GST Model law, the value of the goods supplied on a free of charge basis by a service recipient to the service provider would be includible in the taxable value for discharge of GST.
- As per the Model GST law, goods and services provided free of cost by the service recipient would attract GST when the same would be supplied to the service provider. If the value of such supplies are again included in the taxable value of supplies by the service provider, an amount that has already suffered tax would once again be taxed, leading to double taxation.
- If the service provider is entitled to take credit for this amount, there would be no additional revenue which would accrue to the Government.
- On the other hand, if the service recipient cannot take input tax credit (such as in case of construction of an immovable property), such provision will result in additional cost for the service recipient as the tax would be leviable twice (once at the time of supply by the service recipient, and again at the time of supply by the service provider) on the value of such supplies.
- Overall, industry should represent strongly for deletion of these provisions.

Key Action points

- Advocacy with the Government for deletion/ amendment of aforesaid provisions; and
- Identification of transactions involving free supplies and assessing possible impact.

8. Compliance requirements

Currently, most telcos have obtained centralised Service tax registration certificate and undertake centralised compliances. However, under the Model GST Law, separate registration would be required in each State from where the services are rendered.

Accordingly, telcos could be required to obtain registration separately in each State from where the services are rendered leading to increased compliance requirements as compared to the current regime.

Key Action points

- Identification of States where registration may be required; and
- Appropriate changes required in IT systems to be GST compliance ready.

Let's talk

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

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