Impact of GST – Aviation

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GST implementation – Current state of play

GST is India's biggest tax reform in the post-independence era. Prior to the introduction of GST, a heterogeneous indirect tax structure existed in India which included levy of taxes by the centre and states under different tax laws. The earlier indirect tax framework had challenges of multiplicity and cascading of taxes, apart from other issues and complexities, both technical as well as from the perspective of ground-level practices.

The GST regime implemented on 1 July 2017 has transformed the Indian economy with its 'One Nation, One Market, One Tax' principle by subsuming a host of indirect taxes charged at varied rates by the centre and states, therefore bringing uniformity in taxation across the country. The GST law ushered in numerous positive aspects such as uniformity in tax rates across India, widening of tax base on account of transparent digital processes, subsuming of as many as 17 taxes and multiple cesses, elimination of check posts at state borders etc. However, a year into the goods and services tax (GST) regime, initial apprehensions have given way to general acceptance that the tax structure is a work-in-progress as there are several concerns that remain to be addressed.

One of the biggest challenges in implementation of GST was the functionality of the technology infrastructure and experience of compliance processes; as since inception, the portal had a slow response rate, performance issues and bugs. The Government has constituted a committee to address these issues and it is continuously working on improving the tax payer's experience and various steps at simplification of process has been continually introduced.

The implementation of the E-way bill also brought with it operational and technology challenges due to which the Government took additional time to get the framework up and running. The portal was revamped and was introduced in February 2018 and is completely functional since April 2018 on a pan-India basis. The automation of E-waybill system is a welcome relief from the previous practice of manual checking of way bill information are check posts in different States which led to different legal interpretations and required maintenance of different types of documentation/ records based on State VAT law provisions.

An important aspect of the implementation of a new law is to have a quick and robust dispute prevention and resolution mechanism. Acknowledging the need for suitable clarifications, the Authority for Advance Ruling (AAR) has been set up in multiple jurisdictions across India. The AAR has been fairly proactive in disposing off advance ruling applications, especially in Karnataka, Maharashtra, Kerala and Gujarat. However, given that the AAR is constituted at a State level, there is a possibility of contrary rulings by two different AARs. This indicates a need for a central management system. Further, the appellate process for challenging such advance rulings is not completely robust as yet. These factors are placing the efficacy of the advance ruling mechanism in doubt in the minds of the tax paying community.

Even after one year of GST go-live, there has been deferment of implementation of provisions relating to advances and purchases from unregistered vendors, Tax Collection at Source (TCS) for e-commerce players and Tax Deducted at Source (TDS) for works contractors which leads to an atmosphere of ambiguity for existing businesses as well as those looking to set up new ventures.

One of the focus areas under GST law is the "matching concept", wherein a buyer is required to reconcile its tax payments on invoices with the tax collections, deposited and reported by the supplier on the Government portal. Any incorrect or unmatched transaction would lead to denial of credit to the buyer. However, due to IT glitches, this concept did not take off since GST implementation and the requirement was deferred till necessary technological framework was put in place by the Government. The Government has now approved formats of simplified single monthly / quarterly GST return to reduce the compliance burden on the taxpayers for replacing the multiple returns that were required to be filed for a tax period. Further, the Government has

also introduced provisions to allow taxpayers to amend their tax returns in order to rectify errors which would widen the scope for availing input tax credit.

Anti-profiteering provisions mandate passing on the tax benefit due to GST to the customers by way of price reductions. Implementation of the anti-profiteering provisions is one of the key areas of conversation amidst the industry players. While the regulations seek to prevent entities from making excessive profits on account of GST implementation, an overarching anti-profiteering provision under the GST law without clear guidance or explicit rules has led to considerable ambiguity.

While the above seeks to provide an overview of challenges being faced by all assesses, there are also sector specific concerns and focus areas in the aviation space. This paper attempts to cover such key sector specific concerns.

Impact of GST on Aviation sector

1. Effective Tax Rate

The GST rate applicable for flight tickets on economy class is 5% while business class fares attract a GST rate of 12%. In contrast, the service tax rates applicable under the erstwhile service tax regime were 6% and 9% respectively.

A major portion of the revenue generated from airlines is attributable to air fare collected from economy class travelers. Moreover, airlines can only claim input tax credit (ITC) on input services for the economy class revenue, while for revenue from the non-economy class (ie business class or first class) they can claim ITC for inputs (such as spare parts, food items etc) as well.

Thus, the airline sector has seen a positive change in tax rates for economy class travel under GST as compared to the erstwhile service tax regime.

2. Cascading effect of taxes on Aviation Turbine Fuel (ATF)

Presently, ATF is kept outside the scope of the GST law. Therefore credit of tax paid on purchase of ATF (typically VAT in the state where re-fuelling occurs) cannot be claimed which adversely affects the input cost and has a cascading effect on air ticket prices. Moreover the rates of VAT can vary from state to state.

As ATF prices have risen significantly since January, 2017, the airline industry has made a representation for inclusion of ATF in the GST regime. Bringing ATF under the GST net and allowing credit could partially cushion the airlines from the burden of increased fuel prices. Moreover, such move can also enable airlines to pass on the benefit of reduced pricing to its customers.

3. Exemption on aircraft lease / purchase

Prior to introduction of GST, aircraft carriers did not pay any indirect taxes on lease of aircrafts into India. Under financing lease arrangements, service tax was chargeable only on 10% of lease rental value (ie due to a 90% abatement for services of leasing of aircrafts) and operating lease agreement did not attract service tax. Customs duty was also not leviable on import of aircraft by scheduled operators.

At the initial stages of GST implementation, cost of aircraft import under lease had increased as GST @ 5% was applicable on transactions involving leasing of aircrafts due to restriction of credits. After considering industry representation, the government has pegged a “nil” rate for levy of IGST on aircrafts imported under a lease arrangement. The import of aircraft and its spare parts into India has also been exempted from the levy of customs duties.

This move has bought big relief to civil aviation industry by resolving the issue of double taxation.

4. Place of supply for passenger transportation

Typically, in case of the airline industry, the head office is located in one state with multiple airport offices being located across India. The tickets are sold for flights embarking from any/all the states in India.

The GST law provides that where a supply is made from a place of business for which registration has been obtained, the location of such place of business shall be the location of supplier of services and every supplier shall be liable to be registered in the state from where the taxable supply is made. Thus, in order to determine the location of supplier of service, it is imperative to determine the place of business from where a supply is made. It needs to be analysed which of the following can be construed as the location of the service provider:

- location of ticketing office / location of agent selling the ticket;
- location head office;
- location from where the passenger embarks the flight.

The ticketing office/ agent sells tickets for the airline and cannot be deemed to be providing a service on behalf of the airline to passengers as an agent. Further, the head office acts as a governing/administering unit. Thus, location of the ticketing office / agent or head office cannot pre-se be said to be providing passenger transportation service.

In case of passenger transportation services, the actual or substantive elements of provision of service commences on issuance of the boarding pass at the airport when the passenger arrives to travel and avail the passenger transportation service. Therefore, the location of supplier of service of transportation of passengers by air could be equated to the location from where the passenger embarks for the flight.

5. Supplies made under an Interline / Code share arrangement

In case of an Interline / Code share arrangement, an airline (ie marketing carrier) issues a ticket to the passenger on its own name for the entire journey for a flight operated by another airline (ie Interline partner / operating airline). The marketing carrier contracts with the passengers to provide services in relation to passenger transportation as well as with the operating carrier to fly the route in which the marketing carrier does not operate.

The question is whether the marketing carrier will be required to obtain registration in place of embarkation for the route operated by the Interline / Code share partner and sold by the marketing carrier. Further, it needs to be examined whether the marketing carrier is responsible to collect and pay GST on the air fare for entire journey including the route operated by Interline / Code share partner. It also needs evaluation if the Interline / Code share partner needs to discharge GST on the portion of revenue remitted by the marketing carrier for the transportation for route operated by the Interline / Code share partner and sold by the marketing carrier.

The GST implication on the Interline / Code share commission earned for the aforesaid arrangement also needs to be determined.

6. Interpretation of the term “continuous journey” for passenger transportation

Under the GST law, a “continuous journey” has been defined to means a journey for which:-

i. a single ticket has been issued for the entire journey; or

ii. more than one ticket or invoice has been issued for the journey, by one service provider, or by an agent on behalf of more than one service providers, at the same time, and there is no scheduled stopover in the journey.

The term "stopover" has been explained to mean a place where a passenger can disembark either to transfer to another conveyance or break the journey for a certain period in order to resume it at a later point of time.

As per the clarification issued by the government for the Transport and Logistics sector, all stopovers do not cause a break in continuous journey. Only such stopovers for which one or more separate tickets are issued would be treated as a separate journey. Therefore, if a single ticket is issued for a particular route, then, irrespective of the halt at any location in between, the journey shall be a "continuous journey".

If the location of the recipient of the service (i.e the passenger) as well as the place of embarkation are in India, the return journey shall be treated as a separate journey even if a single ticket/right to passage is issued for the onward and return journey.

For example, for a travel on Delhi-London-New York-London-Delhi on a single ticket where the passenger is located in India, the journey of Delhi-London-New York shall be considered as a continuous journey. However, the return journey shall be treated as a separate journey. Accordingly, if a single fare is charged under a single ticket for the entire journey Delhi-London-New York-London-Delhi, the fare shall be required to be split as being attributable to the return journey of New York-London-Delhi.

Where either the location of the recipient of the service (i.e the passenger) or place of embarkation is outside India, no separate treatment of return journey has been prescribed. Thus, where a single ticket is issued for both onward and return journey, the return journey shall not be treated as a separate journey.

Thus, in cases where a single ticket is issued and if the return journey is deemed to be a separate journey under the GST law, the valuation of supply of passenger transportation services in respect of the return journey becomes relevant for determining applicability of GST.

7. Applicable rate of GST for more than one class of travel in a journey

There is no provision under the GST law to determine the taxability in cases where the passenger travels in more than one class of travel on a 'continuous journey' as defined under GST law.

For example, the passenger travels in economy class for one leg of the journey and non-economy class in other legs of the journey where a single ticket is issued.

In absence of any clarification issued by the government in this regard, the industry is inclined to apply the GST rate as applicable on the class in which the first leg of the journey is travelled. For eg. in a Delhi-Dubai-London-New York flight, if a passenger travels in non-economy class for Delhi-Dubai sector and in economy class for Dubai-London-New York sector, then, the airlines are discharging GST at the rate of 12% i.e. as applicable to the non-economy class for the entire route of Delhi-Dubai-London-New York.

There is an ambiguity on the GST rate to be adopted in cases where the passenger class is either upgraded (say from economy to non-economy class) by recovering an additional fee from the passenger; in case where the passenger opts to travel by an economy class from non-economy class, an amount is refunded by the airline company to the passenger on a continuous journey.

8. Taxability of ancillary charges

Airlines provide ancillary services such as excess baggage charges, date change charges, un-accompanied minor fees, preferred seat charges, cancellation fees etc. in addition to transportation of passenger by air service.

The airline industry had filed various representations regarding taxability of other charges recovered by the airlines such as name change fees, special baggage charges, charges towards provision of oxygen on board etc. It was clarified by the government vide the 'FAQs on Transport and Logistics' sector released on December 27, 2017 that ancillary services are part of the service of transporting of passenger by air and do not constitute a separate supply of service.

As such charges cannot be provided in isolation by the airlines, a view could be taken that the same should be treated as naturally bundled with the principal supply of transportation of passengers by air service and should attract the same rate of GST as applicable to the transport of passengers by air.

9. Taxability on forfeiture of ticket prices, penal charges, compensation paid for baggage losses

Forfeiture of the ticket prices collected from the customers or re-scheduling charges are penal charges levied on the customers or agents are recovered towards the monetary loss incurred by the airlines due to non-provision of service to the agents and customers. In such case, one view may be explored that there is no supply of services of goods from the airlines/ customers and hence the charges recovered/ paid by airlines may not be subject to GST. However, there is an equal argument that cancellation or re-scheduling of tickets / bookings is an active facility offered and is therefore akin to a service in the current commented context.

Conversely, the compensation paid to the customers for loss of baggage is paid to recuperate the loss suffered by the customer due to loss of baggage. In such case, it could be argued that the passenger/shipper tolerates an act of deficiency of service by the airline, thereby involving a supply of services by passenger/shipper to the airline.

10. Taxability of Passenger Service Fees ('PSF') and User Development Fees ('UDF') and airport taxes collected by the airlines from the customers on behalf of the airport

As per the provisions of Indian Aircraft Rules, 1937, Airport Authorities of India ('AAI')/Airport operator have been empowered to collect PSF and UDF from the passenger in consideration of amenities provided at the airport such as:

- Airport security;
- Passenger facility; and
- Construction, management and operation of the airport, etc.

As the airport operator cannot administratively collect such amount directly from passengers, it authorizes the airlines to collect such fees. Additionally, Directorate General of Civil Aviation ('DGCA') mandates the airlines to collect such fees on behalf of the AAI.

The GST law provides that the expenditure incurred by the supplier as a pure agent of the recipient of supply shall be excluded from the value of supply subject to satisfaction of certain conditions. The airport operator provides services to the passenger and not to the airlines. The airlines merely act as a collecting agent on behalf of the airport operator and recovers only the actual amount payable to such airport operator. The airport operator discharges GST on the amount recovered from the passenger. Thus, airlines merely act as a pure agent at the time of collection of such airport taxes from the passengers.

In the instant case, airlines may deduct the airport taxes so collected from the amount recovered from the passengers as a pure agent to arrive at the taxable value of supplies. This is parallel to the position under service tax regime.

11. Applicability of GST on charges collected for upgradation of class of travel post issuance of tickets

Food and beverages are supplied free of cost by the airlines to their business/ first class passengers on-board the flight. Additionally, pick up and drop facility is provided by the airlines to their business/ first class passengers.

The activity of providing free food and beverages along with pick up and drop facility could be construed as an ancillary activity to the transportation of passenger by air services and therefore bundled with such service. It can be said that such service is naturally bundled with transportation of passenger by air service and such services are supplied in conjunction with each other in the ordinary course of business, wherein transportation of passenger by air service is the principle service. Therefore, the bundle will be treated as a "composite supply" and shall be treated as the supply of principal service i.e. transportation of passenger by air service.

Under the GST law, the ITC of the GST paid on food and beverages, rent-a-cab services can be availed by a taxable person who uses the same for making an outward taxable supply of the same category of goods or services or both or as an element of a taxable composite or mixed supply. In the instant case, the same are used by the airlines for providing the taxable composite supply of transportation of passenger by air to their passengers. Hence, a case to claim ITC of the same by the airlines could be explored.

12. Capitalisation of fixed assets purchased in India by foreign airlines

The international airlines operate on a Head office-Branch model where the Head office is located outside India and the branch is located in India. The branch office of such airlines is neither required to maintain books of accounts in India by way of an exemption notification under the Companies Act, 2013, nor required to file details of capital assets of its Indian offices/stations under any other regulatory provisions, statues or laws in India. In such cases, the fixed assets purchased in India are not capitalised in the books of accounts of the branch in India but in the books of accounts of the Head office outside India.

The term "capital goods" is defined under the GST law to mean the goods, the value of which is capitalized in the books of accounts of the person claiming the credit.

The above exemption to the Indian branch cannot be considered as a reason for non-applicability of provisions of capital goods merely because no books of accounts are maintained in India due to a particular dispensation under a separate law. The provisions of the GST law are to be applied under normal circumstances in conjunction with provisions prescribed under other laws in India. Therefore, all goods which would have ordinarily been capitalised as per the generally accepted accounting principles in India had the airlines been maintaining books of accounts in India, should be treated as capital goods for the purpose of applicability of GST provisions in India. Moreover, the capital assets are actually capitalised in the books of accounts of the head office; thus potentially satisfying the substantive requirement of law.

13. Valuation for discharging GST for the transportation of goods by air service

In case of air transportation of goods, the airlines do not come into direct contact with the shipper. Airlines deal with the agents and the airlines give a price cap to the agent for selling the service to the shipper.

Airlines are not always aware of the actual price at which the space is sold by the agent to the shipper. The agent is responsible to make the payment to the airlines for such services at the pre-agreed rate irrespective of the amount at which the space in the aircraft is finally sold by the agent to the shipper (e.g. an airline company has appointed an agent to sell the space in the aircraft for INR 90/ kg with a price cap of INR 140 / kg. The agent can sell the space in the aircraft for any amount upto INR 140 to the

final customers and he is liable to pay INR 90 to the airlines for such purchase of space by the shipper. The airlines would not be aware of the actual price at which the shipper has procured the space in its aircraft. The entire consideration beyond INR 90 is retained by the Agent X appointed by the airlines as its commission).

The GST law defines the "recipient of supply of goods or services" as the one who is liable to make the payment of the consideration for such supply. In the instant case, the shipper is contractually responsible to make the payment to the airlines. Additionally, the shipper has a direct recourse to the airlines for any loss suffered by him during the transportation of goods by air due to negligence on part of the airlines. Thus, the shipper should qualify as the recipient of such services.

However, since the airline has no visibility of the amount charged by the agent from the shipper, the airlines should raise an invoice on the agent for the fare recovered from him and should treat him as its customer. However, the place of supply should be determined based on the details of the ultimate shipper. This would ensure that the revenue of GST is accruing to the state where the services are actually consumed. Additionally, the agent should discharge GST on the rate recovered from the shipper determining the place of supply considering the shipper as its customer, while there is a debate on whether the agent should only charge tax on its commission.

14. Reversal of input tax credits

Services by way of transportation of goods by an aircraft from customs station of clearance in India to a place outside India are exempted[1] from the levy of GST. The said exemption is applicable only up to 30 September 2018. *(This exemption is extended till 30 September 2019 based on the GST council meeting dated 21 July 2018)*

The GST law provides that where the goods or services are used partly for effecting taxable supplies and partly for exempt supplies, the amount of ITC on such goods or services shall be restricted to amount attributable to the taxable supplies. The mechanics of such reversals require substantially complex application of reasoning and details and will need to be addressed by the industry.

15. Taxability on movement of aircraft engines and parts from one state to another for repairs and maintenance of aircrafts

The GST law provides for an inclusive scope of the term "supply" and provides that the supply of goods and services to a distinct person without a consideration would be subject to GST. With respect to the movement of aircraft engines and parts from an establishment in one State to another, is only to enable other stations (located in different states) to provide repair and maintenance support services and are not supplied for consumption by other stations. There is no supply of goods and accordingly, GST should not be levied on such movement of goods.

A recent circular[2] issued by the government clarifies that inter-state movement of rigs, tools and spares, and all goods on wheels (like cranes) between distinct persons for repairs and maintenance shall be treated neither as supply of goods or supply of service, except in cases where movement of such goods is for further supply of the same goods.

As aircraft parts are in the nature of spares and the movement of such spares from one State to another is for the repair of parts or for the maintenance of aircrafts, the movement of aircraft engines and parts will not be liable to GST.

16. E-way bill compliance

[1] *Notification No. 2/2018 - Integrated Tax (Rate) dated 25 January 2018*
[2] *Circular No. 21/ 21/ 2017-GST dated 22 November 2017 read with Circular No. 1/1/2017-IGST dated 7 July 2017 issued by the CBIC*

As regards requirement of e-way bill, considering that the inter-state movement of aircraft parts is treated as neither supply of good or services, ideally an e-way bill should not be required and the movement can be made under a delivery challan, by treating the movement as 'for reason other than supply'.

The GST Act requires taxpayers to intimate a common dedicated portal about the nature, origin and destination of goods being moved, if the value of the consignment is in excess of Rs 50,000. A recent writ petition[3] decided by the Madhya Pradesh High Court in case of Gati Kintetsu Express Private Limited empowers the authorities across states to be more vigilant to scrutinise the consignments and impose penalties for non-adherence to e-way bill norms.

Thus, there is a practical challenge of business coming to a halt if goods are confiscated for want of e-way bill. Hence, from a practical & business standpoint and on a conservative basis, it would be important to ensure generation of e-way bills.

17. Representation for MRO exemption

The aviation maintenance, repair and overhaul (MRO) industry has sought exemption from GST and has requested the government to either abolish 18% GST levied on the sector or impose customs duty on aircraft that get serviced out of India to create a level playing field.

The MRO industry claims that foreign MRO units have prospered since GST implementation as no customs duty is levied when an aircraft gets its spares from overseas and brings it back to India. The present GST rate makes servicing aircraft in India a costlier affair compared to sending the aircraft abroad for servicing.

18. Adjustments for Cancellation of bookings, rebates, etc.

In the airline industry, the customers may book journeys well in advance (ie before the financial year in which journey pertains to). Subsequent cancellation of booking is a common event in airline industry wherein the amount paid by the customer may be refunded in whole or part. However, the time limits prescribed under the law for issuance of credit notes pose a challenge for tax adjustments on the portion refundable to the customer.

The prescribed time limit for issuance of credit note would lead to tax loss in many cases.

19. Taxability on transaction between employer and employee

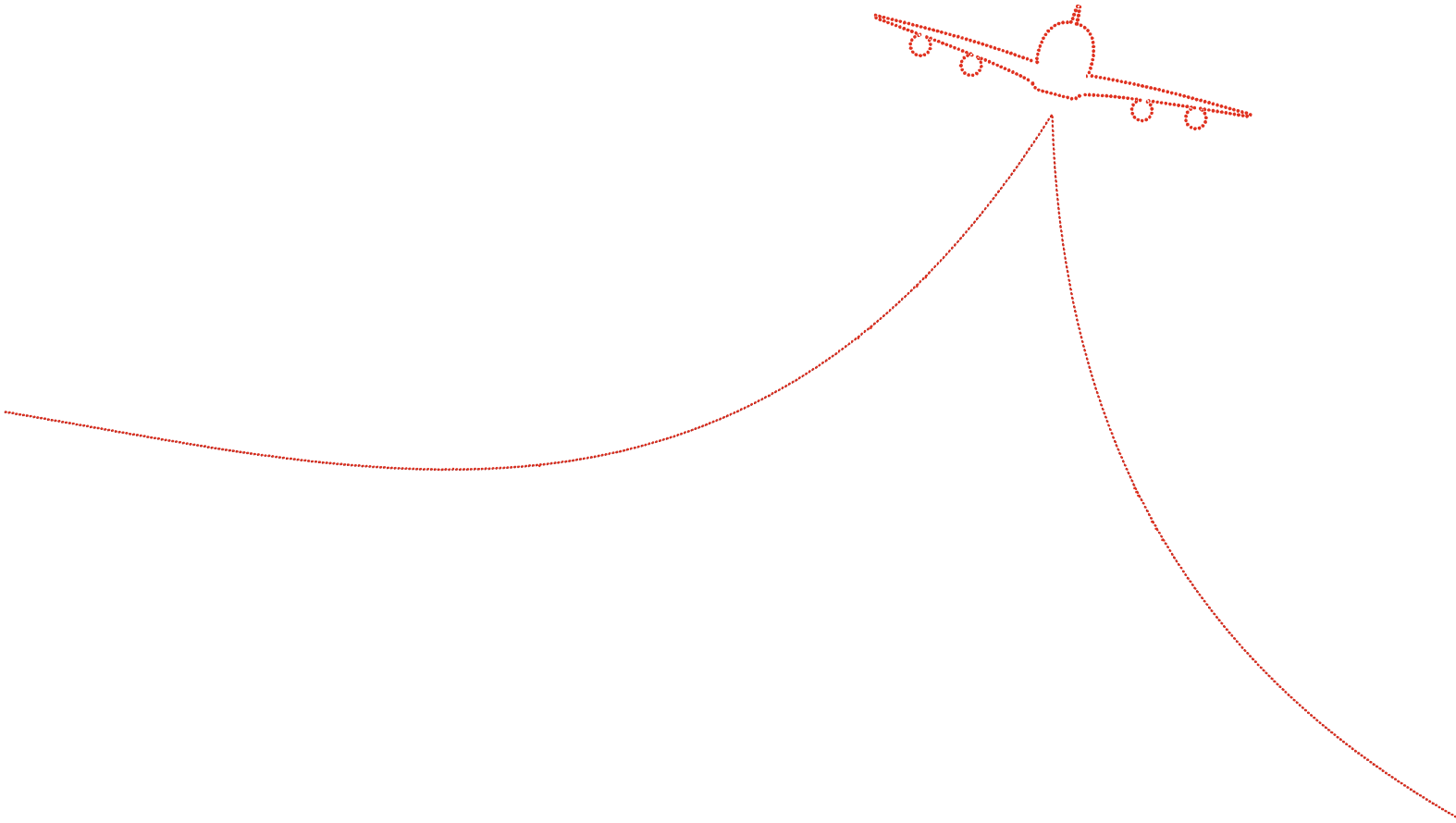
Employer and employee are deemed as related parties under GST and supplies to related parties even without consideration is a taxable supply. Therefore, all transactions between employers-employee need to be analyzed *qua* the said provision. Supplies from employee to employer of gifts upto INR 50,000 per employee are exempted from GST. Therefore, any additional discount offered to employees on air travel could require the airline company to discharge tax on the open market value of such supply (ie the value typically charged to its third party / unrelated customers).

[3] *2018-VIL-293-MP*

In Conclusion

The introduction of GST law has increased the compliance cost applicable to the airline company. Airlines are required to register in every state in which they provide service and are presently still grappling with aligning the global distribution systems to keep up with the evolving law.

To smoothen the process, the government has provided numerous favourable measures such as exempting GST on inter-state movement of aircrafts, reduced rate for lease premiums. Requirement to reverse ITC, added cost of inputs due to ATF kept outside the ambit of GST is posing considerable hardships on the industry.



Thank you

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