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RECOMMENDATIONS ON GST TO COMMITTEE OF EXPORTS

Contents

Legislative issues

1. Refund of GST paid on capital goods

Background

The first proviso of Section 54(3) of the CGST Act provides two instances where refund can be claimed:

(a) Zero rated supplies made without payment of tax; and
(b) Inverted duty structure

Further, as per explanation 1 to Section 54, *"refund" includes refund of tax paid on zero rated supplies of goods or services or both or on inputs or input services used in making such zero rated supplies, or refund of tax on the supply of goods regarded as deemed exports, or refund of unutilized input tax credit …"*

Basis the above provisions, an exporter of service is not eligible for refund of GST paid on capital goods used for providing export of services as refund is eligible only on "inputs" and "input services".

This would put undue strain on the finances of the company as units which are engaged in 100% exports have huge investments by way of capital expenditure. This is important especially as the upfront exemption (Excise duty / customs duty) on procurement of capital goods by EOU/ STP units has been withdrawn under GST.

Recommendation

Refund of input tax credit pertaining to capital goods should therefore be permitted by amending the provisions of section 54 of CGST Act, 2017.

Where allowing of refunds is seen as difficult in one shot owing the quantum involved in case of capex, the amended provision may also prescribe a staggered manner of refund to be granted.

2. Extension of upfront exemption to STP/ EOU units

Background

The IT sector has greatly benefitted from the STP and EOU schemes introduced way back in 1994. The schemes governed by the Foreign Trade Policy have contributed substantially to India's growth and to its GDP. In fact, the IT/ ITeS sector revenues have grown from contributing 1.2% to the GDP in 1998-99 to around 7.7% in 2016-2017.

The sector's contribution by way of increase in employment (both direct and indirect) and for promotion of innovation and entrepreneurship is significant and has overall provided the Indian economy some much needed impetus.

Currently, STP/ EOU units as well as SEZ units were eligible to import goods duty free. In other words, there was an upfront exemption provided to duties of import for capital goods.

Not only has the GST Law discontinued the upfront exemption to STP/ EOU units, but it has also not allowed for claiming of refunds of taxes paid on capital procurements which would be a huge burden to such units as it would become a cost.

Recommendation

Thus, there is a need for upfront exemption to STP/ EOU units in line with what has been made available to SEZ units. Further, the requirement of claiming upfront exemption should be simpler with the least amount of paper work as the STP/ EOU units would any have furnished bond/ legal undertaking with the DGFT authorities that can be relied upon in case of non-compliance.

3. Head office branch office transactions

3.1. GST implications on transactions between head office and branch offices outside India

Background

Indian IT Companies operate through a global delivery model where some part of the contract is executed through its branch outside India. These branches deliver the service directly to the customer outside India. As per the terms of the contract, one integrated price may be paid to the Indian HO and the HO in turn transfers funds to the branch for its expenses. Since these services are provided outside India to foreign customers outside India, these should not be regarded as import of services.

Judicial precedents under the current law have clarified that such transactions between Head office and overseas branch office is not taxable. However, retaining the definition without a clarification may lead to confusion and litigation all over again.

Further, the onsite services are provided by overseas branch directly to the customers abroad and do not provide services to HO and therefore, the funds transfer between head office and branch office outside India with respect to services provided by the branch outside India should be outside the ambit of GST.

Recommendation

- It is recommended that to the extent that services are provided onsite and received by the end customer overseas, the fund transfer between the overseas branch and the Indian head office should not be liable to tax.
- Further, the definition of “import of services” under Section 2(11) of the IGST Act to be amended to exclude HO-BO transactions.

Alternatively, Rule 27(7) of the CGST Rules which provides that value of taxable services for specified classes of service providers may be notified on the recommendation of the Council to be used to prescribe that fund transfers between overseas branches and Indian head offices would be NIL.

3.2. Input tax credit availment in respect of services availed by head office in provision of services to overseas branch office

Background

Section 2(6)(v) of IGST Act defines "export of service" to exclude transactions between Indian head office and overseas branch office.

However, such definition may lead to a scenario where the input credit availed by head office for use in providing services to branch office outside India may be denied and it would result in double whammy to the company.

Recommendation

- It is recommended that a clarification be issued that input credit availed by Indian head offices for use in providing services to branch offices outside India shall not be denied.

3.3. Clarification on HO salary cost apportionment

Background

In order to prepare location Profit & Loss for Sec 10AA claim for SEZ, IT companies having multi state/division operation, apportion HO employee salary cost (e.g. CEO, CFO Etc.) to respective units/ states/ division. Since the salary cost is not subject to GST, their further apportionment also should not be subjected to GST.

Moreover, HO is not providing any services to respective units.

In fact, in Part 4 of the recently issued FAQs this exact issued has been clarified:

Q. 15 Would head offices providing centralised HR, Finance and IT functions also need to raise invoices to its branches?

Ans Yes, if the head office and branches are distinct persons as specified in Section 25(4) of the CGST Act, 2017, invoice is required to be issued and GST should also be paid.

Recommendation

It is recommended that a clarification be issued that there would not be any GST on HO salary cost apportionment to States/ units and the FAQs be amended to this extent as under no circumstance can a head office managing country-wide operations be construed as providing any "supply".

4. Lack of clarity on continuation of various schemes under FTP

Background

The Foreign Trade Policy ('FTP') provides various export incentives such as Service Exports from India Scheme ('SEIS') and Merchant Exports from India Scheme ('MEIS') and duty

exemption/ remission schemes such as Duty Free Import Authorization ('DFIA'), Advance Authorization Scheme ('AAS') and Export Promotion Capital Goods Scheme ('EPCG').

However, there is lack of clarity on their continuity under the GST regime. The duty scrips are also not being allowed for payment of IGST/ CGST.

Further, it is important to note that such schemes provide for upfront exemption from payment of BCD only with requirement to discharge IGST, which results in unnecessary working capital blockage in respect of export of final products or services.

In addition, withdrawal of such exemptions could fundamentally change the attractiveness and viability of setting up units for exporter of goods or services.

Recommendation

It is recommended that the benefits currently available to the industry under the FTP be as is extended to them under the GST regime as well, else, it would create an unnecessary burden upon the exporters.

In addition, where procurements are made through advance authorization, EPCG, etc, it is recommended that IGST also be made exempt apart from the BCD component.

In respect of SEIS, MEIS or any other duty scrip, the provisions should be amended or relevant notifications be issued to provide for utilization of such scrips for payment of IGST and CGST as well.

5. Valuation (in the case of exports and SEZ supplies)

Background

Second Proviso to Rule 28 of the CGST Rules provides for provisions relating to valuation of supplies to be adopted in case of supply between distinct persons.

As per the said proviso, where recipient is eligible to claim full input tax credit, the value declared shall be deemed to be open market value.

In cases where the end supply is either exported or made to SEZ units, it would lead to payment of GST on such self-supplies in one State and claiming a refund in the State from where the end supply is made. This would lead to an unnecessary blockage of working capital for export entities without any domestic supplies.

Rule 32(7) of the GST Valuation Rules provides that the Government on recommendation of the Council may notify that the value of deemed taxable supplies (specified in Serial number 2 of Schedule I – supplies between distinct persons) would be NIL.

Recommendation

It should not be mandatory to attribute value and discharge GST with respect to supplies between two distinct persons in cases where the end supply is exported.

Hence, it is recommended that the value of taxable supplies between distinct persons be notified in scenarios involving export of services from the intermittent supplying location as NIL vide powers under Rule 32(7). In addition, it can also be clarified that an SEZ unit is eligible for claiming upfront exemption in respect of services availed from other distinct person belonging to the same legal entity.

6. Services provided to Nepal/Bhutan not qualifying as "exports" where the consideration is not received in convertible foreign currency

Background

As per Section 2(6) of the IGST Act, the following conditions are required to be satisfied in order for services to qualify as "exports"

Condition 1 – Supplier of service is located in India

Condition 2 – Recipient of service is located outside India

Condition 3 – Place of supply of service is outside India

Condition 4 – Payment of services is received in convertible foreign exchange

Condition 5 – supplier and recipient of service are not merely establishments of a distinct person in accordance with explanation 1 in Section 8

However, several IT companies provide services to customer in Nepal/ Bhutan where the consideration is not receivable in convertible foreign exchange.

In such situations, the services provided would fail satisfaction of condition 4 above and would not qualify as "export of services".

Recommendation

It is recommended that clause (iv) in Section 2(6) of the IGST Act be amended to read as "payment for such services has been received by the supplier of services in convertible foreign exchange other than cases where services have been provided to Nepal/ Bhutan".

Alternatively, an exporter of service may be made to reverse proportionate input tax credit in respect of supplies to Nepal/ Bhutan rather than discharging GST on the output service.

7. Lack of clarity on classification on various types of software

Background

Under the erstwhile law, software was subject to dual levy. It was expected that this issue would be resolved under GST with all types of software categorized as "services"

However, sectoral FAQs released for the IT/ ITeS sector have clarified that any kind of pre-developed/ pre-designed software supplied in medium/ through use of encryption keys would be supply of "goods"

This would lead to:

(a) Lack of clarity on what would qualify as “temporary transfer or permitting the use or enjoyment of any IP rights

(b) Difficulty in determination of place of supply

(c) Relevance of EULA specified in question 18 of the FAQs

Recommendation

It is recommended that it be clarified that all types of software other than on media should ideally qualify as supply of “services”.

Alternatively, FAQs to be amended to provide that only pre-developed/ pre-designed software on media would qualify as “goods”. Everything else would qualify as supply of “services.

Procedural issues

8. Difficulty in submission of LUT

Background

As per Rule 96A of the Central Goods and Service Tax Rules, 2017 ('CGST Rules') any registered person exporting goods and services without payment of IGST is required to furnish a Bond/ LUT with its Jurisdictional Officer.

Further, as per Notification 16/ 2017 – Central Tax dated July 7, 2017 read with circular no 4/4/2017-GST, dated July 7, 2017, an LUT may be furnished instead of a bond subject to receipt of minimum of 10% of the export turnover of the preceding financial year (minimum of Rs 1 Crore).

Companies while furnishing the LUT along with Form GST RFD 11 with the jurisdictional authorities have been facing several challenges and the same have been detailed hereunder:

8.1. Demand for additional documentation with respect to submission of LUT

The only documents that are required to be submitted as per Rule 96A read with the above Notification/ Circular are Form GST RFD-11 and LUT. However, ground level officers have been insisting on additional requirements such as:

- Declaration on the letterhead of the Company regarding details of receipt of foreign currency during the preceding financial year;
- Declaration stating that the Company has not been prosecuted for any offense under any of the existing laws;
- Board resolution in favour of the authorized signatory who has executed the LUT;
- Copies of service tax returns filed in the preceding financial year;
- Copies of FIRC's/ BRCs including co-relation statement of export turnover and foreign remittances etc

In fact, few Officers (especially in case of SEZ supplies) have been insisting on submission of copies of all invoices. Such a requirement is a completely onerous task. In this regard, the following documents are enclosed for your reference:

- Instruction issued by the Assistant Commissioner, Gurgaon Circle detailing points for consideration for acceptance of LUT ;
- Standing order no 1/ 2017 issued by the Additional Commissioner, Officer of Principal Commissioner of Central Tax, GST Commissionerate, Bengaluru;
- Checklist of documents referred to by Officers in the New Delhi Circle.

In fact, CA certificate certifying export turnover and remittances received were also being insisted upon which should no longer be an issue based on the Departmental clarification/

instruction F No 354/173/2014-TRU (GST Cell) Pt II dated July 26, 2017 issued by the CBEC, GST (Policy wing) addressed to all Principal Chief Commissioners.

Para (h) of the said Clarification clarifies that *"Documents as proof of fulfilling the conditions of LUT should be demanded reasonably. Self-declaration should be accepted where either we do not have document or record of an exporter or it would take some time to verify the antecedents of an exporter…"*

Therefore while the recently issued Clarification states that additional documents should be "*demanded reasonably",* it still does not rule out the possibility of different jurisdictions and officers taking varied stances on the kind of documents required to verification of fulfillment of criteria for furnishing of an LUT.

Such insistence on additional requirements has already been causing unnecessary delays in submission of LUTs without which companies engaged in export of services would not be able to make exports without IGST.

Recommendation

We recommend that a standard list of documents be prescribed for submission along with the LUT and Form GST RFD 11. Such list of standard documentation should be the same across all jurisdictions and States.

Further, it is imperative that the list of documents be a simple one containing documents that can be easily furnished. For instance, furnishing of CA certificate, copies of FIRC's/ BRCs requires co-ordination with Bankers and other third parties which again is a cumbersome task.

Therefore, a simplified uniform list of documents to be furnished along with the LUT would ensure that there is no undue delay in exports to be undertaken. This should be done at the earliest to avoid situation of IGST being demanded until the date of acceptance by authorities.

For small companies the requirement of furnishing the Bank guarantee and corresponding additional document is a cumbersome and puts an additional cost burden.

8.2. Absence of online facility for furnishing of LUTs

Currently, in the absence of online facility for furnishing of LUT, Companies are required to co-ordinate with Jurisdictional Officers across States for filing of the documents. This aspect has been clarified in the Circular.

Coordination and filing of LUT with multiple tax offices is taking a lot of time due to the different practices followed at jurisdictional level. The details of jurisdictional offices are not even made available in some of the locations leading to difficulties in submission of LUT

Recommendation

It is recommended that the online facility for furnishing of LUT be made available at the earliest and without any further delay. Also it is hoped that once the requirement of furnishing of LUT is done manually, there should be no additional requirement of submitting/ uploading details of the same online again.

8.3. Clarity on issuance of LUT number

Upon furnishing the requisite details, some Jurisdictional Officers in a few States have been allotting a LUT number. Further, while the Rules do not prescribe mentioning of this number mandatorily on the invoice, several officers are of the opinion that this number is required to be disclosed as a particular in an invoice.

The lack of clarity on this aspect is leading to confusion at the ground level and should not lead to unnecessary disputes taxpayers/ assesses at a later point in time.

Recommendation

It is recommended that clarity be issued that there is no requirement of mentioning any LUT number on the invoice.

8.4. Difficulties for small exporters in furnishing Bank Guarantee

For small companies the requirement of furnishing the Bank guarantee at 15% of the bond value and corresponding additional document is a cumbersome and puts an additional cost burden.

- Small exporters with limited resources and for whom getting bank financing is tough face difficulties in furnishing such bank guarantees.
- For IT exporters who did not have this requirement under the earlier regime this is an additional burden and leads to blocking of capital.
- Further, the recent instructions issued provide that smaller exporters with a good track record will have to furnish a bond on a non-judicial stamp paper while those whose export record is not good will have to furnish a bank guarantee. This is very subjective and will lead to disputes.

Recommendation

We recommend that small exporter's upto a certain threshold of turnover be exempted from the requirement of furnishing a bank guarantee or a reduced % of bond value may be prescribed for such exporters.

9. Facility of amendment of registrations

Background

The window for amendment to registrations has yet to be enabled.

While the Official Twitter handle of the government has clarified that such amendments to registrations would be enabled soon, no such provision has been enabled to date.

This has led to a number of issues such as inability to raise invoices and in some cases operations have also come to a grinding halt.

Recommendation

It is recommended that the window for amendment to registration be enabled at the earliest to ensure smooth running of business operations with minimal interruptions.

10. Issues with return filing

The CGST Rules provide that all applications, including reply, if any, to the notices, returns including the details of outward and inward supplies, appeals or any other document required to be submitted are required to be submitted electronically with digital signature certificate ('DSC') or through e –signature as specified under the Information Technology Act, 2000 (21 of 2000) or verified through any other mode of signature or verification notified by the Board.

However, it has been the experience of taxpayers that several issues are being faced during the process of filing of returns.

Such technical errors have hampered business and led to costly delays.

Recommendation

It is recommended that technical errors such as those detailed above be sorted at the earliest in order to ensure hassle free filing of returns.