Goods and Services Tax in India - Impact on Financial Services Sector  
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With reference to the Indian Indirect Tax perspective, the most awaited year of the decade i.e. year 2017 is within a touching distance marking the implementation of a complete indirect tax revolution viz GST. After almost three decades from the time MODVAT was first introduced in India back in 1986 followed by gradual steps taken by government to facilitate seamless flow of CENVAT across excise and service tax that followed by the negative list regime under service tax, the need of the hour viz. GST looks on track for April 2017 implementation going by the strong intent of the present government. Though the industry preparedness for GST is far from being satisfactory, what needs to be seen is the impact (either positive or negative) that GST would bring in once implemented and how quickly the industry adapts to the changed scenario.

Since the financial sector in our country is highly regulated, a company engaged in rendering financial service in India has to comply with several regulations under different laws apart from compliance under indirect tax laws. Tax base of the Indian Financial Service sector is already substantially exploited by the government. Such wide tax base brings along with it several complications with respect to coverage of subject transaction under the bracket of tax levy. Now, with the government promising that GST would usher in economic growth leading to a spurt in economic activity, let us analyse the impact that GST might have on the financial sector with focus on certain financial services and whether it would resolve the complications prevailing under the present legislation.

Present complications under the Financial Sector from Indirect Tax perspective

1. Collateralized Borrowing and Lending Obligation (‘CBLO’)

CBLO is a RBI backed Money Market Instrument backed by Gilts as collateral. It is an obligation to the borrower of funds to return the money borrowed at a specified future date along with interest. Further, it creates a charge on the collaterals deposited by the borrower of funds with Clearing Corporation of India Ltd.(referred as ‘CCIL’) which acts as a Clearing House. Over the years, the revenue department has tried and failed to tax the fees/discount/interest portion on CBLO by contending that it shall be construed as ‘purchase underlying collateral at a discount’ which is a taxable event under service tax and not in the ‘nature of Interest’ which is construed as ‘transaction in money’, thus excluded from the definition of service tax.

GST implication on CBLO

As per the Model GST Law, services have been defined as ‘anything other than goods”. Thus a cursory look over the definition of services directly puts every thing other than goods under the ambit of services.
In current scenario, service tax under financial sector is levied on all fee-based activities which include various types of charges such as transactions fees, processing fees, etc. However, income from fund based activities such as interest, investment and asset financing and propriety trading are largely outside the tax net. Thus, it would be important that a clear distinction be made between fee based and fund based activities and transactions pertaining to fund based activities are excluded from the levy of GST. If such demarcation is not made, revenue earned through instruments like CBLO might come under the bracket of GST, this time at a rate higher than the current one.

2. Sale of shares of a Private Limited Company: Impact under current legislation

Under the Finance Act,1994 (‘Act’), ‘securities’ as defined under section 65B(43) has the meaning assigned to it in clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956 (42 of 1956) (‘SCRA’).

Securities is defined under SCRA as ‘shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

As reiterated in the pronouncement given in Dahiben Umedbhai Patel And Others v/s Norman James Hamilton And Others (Bombay High Court) APPEAL NO. 42 OF 1979 IN SUIT NO. 487 OF 1972 AND APPEAL NO. 136 OF 1979 IN SUIT NO. 173 OF 1974 [08.12.1982] it is understood that, it can be interpreted that since shares of a private limited company are not marketable, they would not fall under the ambit of definition of securities of SCRA. Consequently, this would mean that the said shares shall also not form part of definition of securities under the Act. This would further mean that the said shares shall also not form part of the definition of goods as per section 65B(25)of the Act. On deriving the said conclusion, the transaction of sale of shares of a private limited company would become taxable under the Act in the absence of any specific entry under the Negative/Exemption List in relation to the said transaction. The tax outgo that an assessee might face in respect of the said transaction would be enormous considering that the amount involved in such transactions is usually huge.

However, what can be debated is that the definition of goods under service tax should be borrowed from The Sale of Goods Act, 1930 since it clearly states that goods includes stocks as well as shares as compared to the present definition under service tax which states that goods includes securities. The authorities cannot levy service tax on goods as that would be ultra vires the constitution.

GST Impact on sale of shares of a Private Limited Company

Currently shares are specifically excluded from the definition of goods under the Value Added Tax (referred as ‘VAT’) laws of all the states. On the flip side, securities are included under the
definition of goods under the Act. The Model GST Law has as it is borrowed definition of ‘goods’ from the current provisions of service tax law thereby covering ‘securities’ under its ambit. However, ‘securities’ per se is not defined under the said Model GST Law. Since, GST is a tax on supply of goods and services what needs to be seen is whether sale of shares find a specific exemption from the levy of GST. In case no such exemption is provided the same would result in a GST impact, this time at a rate much higher than the prevailing rate. Such scenario would heavily curb transfer of shares in the industry that would restrict operations to a significant extent.

Conclusion

It is important to understand and evaluate the implications that a new legislation might have on the existing complications under the current regime. Accordingly, the new legislation in the form of GST should try and resolve the existing complications rather than increase the complexity further. Apart from a simplified tax administration and structure, it is important that government plays a pro-active role in framing GST legislation and addresses the concerns of the industry players in a way that this implementation of the biggest ever indirect tax reform in the country turns out to be a win-win situation for everyone.

References: