# IMPACT OF GST ON FINANCIAL SECTOR WITH SPECIAL REFERENCE TO BANKING SECTOR

**SUMALATHA .R**
Research Scholar, Kalinga University, Raipur, Chhattisgarh
**Dr. HENA NAQVI**
Professor, Kalinga University, Raipur, Chhattisgarh

**Abstract -** The introduction of GST in India is a substantial shift from the current tax regime. It is expected that service sectors will have a major impact on GST than the manufacturing or trading sector. Among the services provided by Banks and NBFCs, financial services such as fund based, fee-based and insurance services will see major shifts from the current scenario. Owing to the nature and volume of operations provided by banks and NBFC vis a vis lease transactions, hire purchase, related to actionable claims, fund, and non-fund based services etc., GST compliance will be quite difficult to implement in these sectors. Under Model GST Law, the framework does not provide much benefits or consideration to banks and NBFCs on an understanding of the type of transactions made by them on a consistent and voluminous basis. Some of the issues and impacts pertaining to the provision of GST Law have been discussed.

**Index Terms –** GST, financial sector, banking sector, Indian economy.

## I. INTRODUCTION

The Goods and Service Tax (GST) was implemented in India from 1st July 2017, approximately 12 years after being first proposed in the parliament in 2006 by P.C. Chidambaram, the Finance Minister during the UPA rule. The tax overhaul is one of the biggest reforms in India's tax code since India's declaration on independence in 1947. GST replaced Service Tax, Excise duty, VAT, Customs Duty, and a slew of other levies charged on Indian businesses.

On the eve of the first anniversary of this landmark reform, we attempt to review its performance and impact on the various drivers of the Indian economy. Simplification of the tax structure is one of the major pillars of the GST regime. With its introduction, the practice of charging differential tax rates on goods (excluding fuel) across various states came to an end. Keeping the 'One Nation One Tax' adage in mind, goods are broadly classified into 4 tax-slabs. Moreover, several essential goods of mass consumption have been declared tax-free.

It is important to note that all types of fuel have been kept out of the ambit of GST as taxes on fuel serve as a huge contributor of tax for the central and state governments and used by them to manage fiscal positions. Any major reduction in these taxes would put a considerable strain on the government's ability to manage national and state finances. Another reason for implementing GST was to formalize the economy and bring more traders under the tax net. The Economic Survey result released in January 2018 has revealed that 34 lakh businesses registered for a GST number during the first 6 months of GST. This has increased the number of taxpayers base by 50%. Besides the immediate registrations, several unregistered dealers are also expected to obtain GST numbers as enterprises continue to show preference towards registered entities.

As per the GST rules, a trader can claim credit for the taxes he has paid on goods and services used for his goods. This is beneficial to the final customer as they are paying taxes on just the final goods and not a double tax, i.e., the tax paid by the trader on the input materials and on the final product as well. This has made several goods such as textiles, daily consumables like soap, and construction material like cement and paints cheaper.

To make sure that the benefits of lower taxes are passed on to the consumers, the government has constituted a National Anti-profiteering Authority. Every registered trader had to file 3 returns per month (now reduced to 2) under GST and one annual return. Additionally, there are other returns for input service distributors, job-work, etc. which add to the compliance burden. This has resulted in an increased cost of compliance as all businesses have had to hire additional resources for maintenance of tax books and filing the various returns.

Service providers have been especially hit with the compliance requirements as they now have to file a minimum of 25 returns in a year, up from one every 6 months under the previous laws. When the GST was implemented last year, some industries that began paying a higher tax, like restaurants, immediately hiked their prices to pass on the impact to its customers. However, when the government reduced taxes late last year, it is widely believed that the benefits have not been passed on to the customers.

Similarly, the government's anti-profiteering body has asked for clarifications from FMCG companies if the dual benefits of price reductions and Input Tax Credit have been passed on to the customers. As mentioned above, since this is the first year of the regime, most issues are expected to be ironed out as companies exhaust their old inventory and the entire supply chain accounts for the new tax rates.

The micro, small, and medium enterprises (MSMEs) were just recovering from the demonetization drive implemented in November 2016 when GST was implemented in July 2017. The biggest impact of GST in the short term has been felt by this group. This was primarily due to the hiccups in compliance and inefficient government machinery to process and refund tax credits during the initial months. As per a report by Dun and Bradstreet, the Daily Sales Outstanding (DSO) of MSMEs has increased from 58 days to 70 days, increasing their working capital requirements.

Similarly, MSME export houses have also had to bear the brunt of a delay in processing of tax credits. The initial issues in processing the Input Tax Credit (ITC) severely marred operations. Also, the requirement of higher ticket loans from banks and NBFCs made businesses lose profits in the short-term.

This article is organized as follows. Section II consists of literature survey . Section III describes the GST and Its Impact on Financial Sector. Section IV describes about the Impact of GST on Banking sector, section V describes the Issues related to revenue recognition under GST. Section VI describes the Issues And Impacts Pertaining To The Provision Of Gst Law. Section VII describes the Benefits of GST for Banks and NBFCs and the work is concluded in section VIII.

**II. RELATED WORK**

According to the article published in The Economics Times dated on 03-07-2017 Mr.Gopal Balachandran, Chief Financial Officer, ICICI Lombard. said GST has a mechanism of reconciliation of output services and input services, and banks may get the credit of each eligible input service. Overall, the monetary impact may be negative initially, but complete transparency in transactions will show positive results for the banks and the economy in the long term.

According to the ariticle published in www.equitymaster.com dated on 11-07-2017: How GST will affect your financial security, while handling your investments and savings.

Currently, large number of the banks and financial institutions have proactively communicated the revised service tax system to their clients via e-mails or text messages. So, under the new tax system, the service tax rate on almost all banking, insurance and capital market transactions will be 18% as against the 15% charged earlier.

According to the article published in The Business world on 12-08-2017, Mr. Sanjay Rane, CA & Auditor said, "GST is replacing all taxes with one tax and the change is the supply concept of goods and services that has come into existence. Before banks were charging service tax and receiving input credit. After GST implementation they charge GST on services provided and charge input credit. There are two types of services known as Input and Output where the Output service is similar to the service tax regime

**III. GST and Its Impact on Financial Sector**

**3.1. Difficult Registration Structure**

Before the implementation of GST, all the banks and NBFCs maintained their service tax compliance via a centralised process of registering. Even when these banks had different branches in various states and union territories, the compliance registration was not done separately.

With GST, banks and NBFCs need to carry out tax registration separately for every branch they have. Since GST is a destination-based regime, it has formed a multi-stage system. The tax is received at every stage and the tax already paid in the last stage is reduced in the next stage. No doubt, it has streamlined the tax structure and helped the industry with enhanced cash flow, but GST compliance is still a challenge.

### 3.2. Hassle of Input Tax Credit

Before GST, banks and NBFCs were able to opt 50% reversal of CENVAT (Central Value Added Tax) credit that was acquired from input services and inputs. The credit for CENVAT on capital goods was reversed without applying any conditions. Now, the terms for this reversal have been changed and for input services, inputs, as well as capital goods, only 50% of availed CENVAT credit is reversed.

In this reference, the impact of GST on banks is great as they are left with 50% reduced credit on capital goods and the cost of capital is overall raised. However, this can be considered as a benefit as well because with a unified tax regime, the production costs are reduced, which automatically increases profitability.

### 3.3 Assessment and Adjudication

GST and its impact on the financial sector is seen in the form of assessment and adjudication changes. Previously, banks and NBFCs had to resort to a particular state regulator, in which that branch was registered, for assessment of service tax. With GST, every branch of banks and NBFCs has to justify its chargeability position in the respective state and provide a reason for input credit tax usage in different states.

Additionally, under GST, multiple adjudication authorities are involved. This leads to delay in adjudication as there may be different opinions on one underlying issue. Pre-GST only one adjudication authority was to be contacted for an underlying issue, which was obviously feasible, fast, and convenient for banks.

## IV. Impact of GST on Banking sector

Goods and Services Tax (GST) regime was rolled out in India on 1st July 2017, and since then every sector and industry saw its effect in varying proportions. However, the impact of GST on the banking sector is high and in a way, the functioning of banks is affected the most.

Amongst all the sectors under GST, the financial industry is one of the major sectors. So, forming a structure to keep up with GST changes is a necessity for banks and NBFCs. But, it is difficult for these banks and NBFCs to adjust to this structure as they provide various services such as lease transactions, loans, hire purchase, and other non-fund and fund operations.

Moreover, the GST has increased the tax to 18% on services provided by banks and NBFCs. Earlier, only 15% service tax was levied on services of NBFCs and banks.

Under GST, banks are expected to obtain individually separate registrations for every branch set up across the country. This is mainly pushing the banking employees from their comfort zones as there was single centralized registration concept for all the banks till now. This problem becomes even more complex being directly proportional to the enormous number of banks and their respective branches that exist in India.

With the advent of GST, the internal, as well as the external monetary transactions between two separate banks, is no longer free. This now comes with a small amount we are expected to pay at the time of a financial transaction.

In the name of GST, we now have two types of taxes – Central GST controlled by the central government and the State GST which is controlled by the state itself. With such types of GST, the entire protocols of the banking sector are changed in terms of the service they provide to their customers. Point of supply identification offered to each customer holding an account in a bank, now have the luxury of transferring any cost to almost any part of India irrespective of the location of the bank the person has the account in.

Previously input tax credit was not allowed according to the CENVAT protocols. But with GST in its full charge, this input tax credit is granted to the banks, reducing the tax evasion during an external supply of funds. In the course of GST, we have the access for ensuring smooth business across India and its neighbouring countries. With such exponential growth in business, a sudden increase in the demands of funds led to the growth in the number of transactions benefiting the banks. This lead to the overall advantage for the banking sector.

A bank provides a diversity of services to its customers: debit card, credit card, net banking etc. With the new rules and regulation for banking under GST, the IT department demanded the up gradation of every system, along with the ATM machines and transaction systems.

## V. Issues related to revenue recognition under GST

### 5.1 Account Linked Financial Services

The place of supply will be the location of the recipient of services on the records of the supplier of services.

In the digitized and centralized scenario prevailing in India identifying the state of location of service recipient will be quite difficult. In cases where the service recipients like professionals, manufacturers, traders, and other workers often shift from one place to other in search of better opportunities, the service provider may have a different address namely permanent address, current address, the address of communication and KYC address.

### 5.2 Non-Account Linked Financial Services

The place of supply of service here would be the location of the service provider. This will again hit such companies which are widespread in remote locations to establish their presence but operate and transact from a back office located in some other state.

### 5.3 Actionable Claims

Actionable claims do not constitute as a service under Service Tax, and hence no tax is payable under the current regime. Under GST actionable claims are now included in the definition of supply of goods. Services provided from bills discounted to securitization will now be taxed as an effect B2C and B2B majorly.

## VI. Issues And Impacts Pertaining To The Provision Of Gst Law

### 6.1 Widespread number of branches; registration a hassle

Currently, an NBFC, Banks with pan-India operations can discharge its service tax compliances through a single `centralized' registration. However, under GST, such Banks/ NBFCs would need to obtain a separate registration for each state where they operate.

In addition to registration, compliance burden about filing of returns has also increased substantially -in terms of the periodicity of returns, number of return formats and level of details required in these returns.

### 6.2 Input Tax Credit leveraged and de-leveraged

Currently, Banks and NBFCs majorly opt for the option of reversal of 50% of the CENVAT credit availed against inputs and input services whereas CENVAT credit on capital goods could be availed with no reversal conditions.

Under GST, 50% of the CENVAT credit availed against inputs, input services, and capital goods is to be reversed which leaves them with a position of reduced credit of 50% on capital goods thereby increasing cost of capital.

### 6.3 Assessment and Adjudication made bothersome

The assessment would be done by the respective state regulators under which the respective branch is registered. Now, every registered branch of banks and NBFCs must justify its position on chargeability in the respective state and reason for utilizing input tax credit in different states.

As under GST, more than one adjudicating authority will be involved, each authority may hold a different opinion on the same underlying issue. This contradiction in opinion will prolong the adjudication process. Currently, a taxpayer is adjudged by a single adjudicating authority on an issue involved. Under GST different adjudicating authority may take a different view on the same issue. Clearing up and dealing with the difference of opinion provided by the different adjudicating authority would be difficult.

## VII. Benefits of GST for Banks and NBFCs

Pre-GST, the banks were only able to receive a partial credit of CENVAT and no state VAT credit on procured goods was obtained. Since all the indirect taxes are subsumed to GST, credit for GST applicable on procured goods can also be availed.

As is widely known, GST curbs tax evasion and reduces the formation of a parallel economy. This will allow financial institutions to reap benefits in the near future with more accounted transactions and increased demand for funds

## VIII. CONCLUSION

Referring to all the banks and the banking sector of India, there has been a drastic change in the basic functioning of every organization. On one side we can go on criticizing about the amount of complexity GST has introduced in the Banking offices which demands upgradation of the software system flooding in, we must also throw some light at the exponential business expansion and the amount of profit is filling the Indian pockets. With the introduction of this uniform tax has been a blessing in disgrace on the poor society and painful for the business tycoons of the country.

With the expectation of further details to emerge, financial sectors face a can of worms in terms of the manner of transacting business, customer profiles, services matrix, IT systems and operation to capture the data at both front and back end. IT systems will need to be more vigilant in terms of serving the purpose of solving the complexity related to GST compliance and procedures at a higher volume.

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