Transitional Challenges under GST[1]

India is committed to implement Goods and Service Tax, expectedly to be implemented from April 2017 onward or a little later. The tax system is currently in the drafting stage with a few undecided issues holding up the agreement between the States and the Centre. Implementation of GST does not just involve tax reform, rather a complete business reform. The* Indirect Taxes Committee *of ICAI examines the various stages and transitional aspects of the GST implementation that need to be considered and the challenges that businesses may face in doing the same. It is of the view that effective GST transition could result in capturing new customers, safeguarding the present market as well as protect the present margin. Read on…

India is committed to implement Goods and Service Tax (GST). GST is expected to be implemented from April 2017 or a little later. The tax system is currently in the drafting stages with a few undecided issues holding up the agreement between the States and the Centre. The implementation of GST does not just involve tax reform, it is instead a complete business reform. The focus is on discipline being enforced on those carrying on business activity. Therefore, changing the historical ways of doing business calls for larger challenges and increased sense of responsibility as any slip up can also have the business continuity/ survival risks.

([1] Contributed by the *Indirect Taxes Committee* of The Institute of Chartered Accountants of India, with inputs from CA. Ravi Kumar Somani. The Committee may be contacted at idtc@icai.in.)

Finalising *GST Transition Model*

The first and foremost challenge is to understand what is the right model for your business to implement the GST. Broadly, there are three models:

a) **Model 1:** ***In-House Implementation Model:*** Implementing GST with its (companies/ business') own internal team by developing a core GST Team. This can be an appropriate model when the system and controls are well-organised and the company has separate tax teams with pool of industry knowledge as well as taxation in order to plan and execute GST implementation. It could only involve outside professionals to validate and confirm its ideas.

b) **Model 2:** ***Out-source Implementation Model:*** This involves outsourcing the entire GST transition aspects from planning to execution to outside professionals. This can be apt where the size of the business is very small and the company does not have adequate resources in terms of professionals with expertise in indirect taxation.

c) **Model 3:** ***In-House + Outsource Implementation Model:*** Developing a core internal GST team plus obtaining the assistance of professionals as a knowledge partners. In this model, GST would be implemented with collaborated efforts of internal team and the outside professionals clearly dividing the roles and responsibilities of internal team and the external experts. This is more appropriate model for major of the companies who have fairly decent capacities in respect of the executing manpower and knowledge of the taxation system. The capacity and the knowledge can be optimally utilised by partnering with the professionals.

Credits Transit, Maximisation, Documentation, Methodology

Various transitional provisions have been prescribed to deal with transfer of credits in the GST regime. However, transition of credits is going to be a big challenge in the GST regime especially for the following businesses:

- Where credits in books have not been/ are not reconciled with returns over a period;
- Book stocks do not match the physical stocks. There is no regular stock taking exercise being conducted;

The Transitional provisions relating to transfer of credits are not clear and provide multiple views. Further, certain aspects of transition of credits are not at all dealt with in the revised model law also. For instance, the methodology for transit of credit availed on Spectrum rights which needs to be availed over a period of 3 years has not been provided in the model law. It is not clear whether the balance 2 years' credit can be transferred to GST regime or not.

- Tax invoices received from vendors are not being properly filed/ documented, or not being obtained at all;
- Ineligible and improper credits are availed in the books and returns with no eligibility checks on the credits;
- Credits are missed either due non-availability of credit availing document or missed due to oversight or credit assumed to be ineligible which is eligible or credits missed transferring in return from the books. Such businesses must run a credit check for the last one year and avail the credits where possible.

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Business Model Restructuring

Businesses could undergo a change due to the advent of GST. Those who act and restructure their model as per the requirements of the GST

would definitely have a competitive edge. Various restructuring aspects that can be considered are:

- Whether to change/merge the manufacturing location, principle place of business;
- Adding/deleting locations of storage and supply, being closer to customers/vendors- Making national presence- No State barriers for supply exist in GST;
- Shutting down locations, warehousing strategy, change in supply chain management;
- Whether floating a new entity for separate business verticals is required?;
- Management hierarchal/reporting changes- Robust de-centralised reporting required;
- Examine the present projects which have been based on position prior to GST;
- Venturing into new avenues;
- Assessing collaborations, partnerships, mergers- Geographical expansion & business line expansions; and
- Change in Sourcing strategies- Local/import/ inter-state/SEZ.

Understanding the nature and extent of re-structuring along with the time required vs available would be important. Further, actual implementation of the restructuring would be critical task and needs to be monitored.

There can be many more such practical scenario's which model GST law has not envisaged and hence not covered. Therefore, it poses a challenge on the businesses as to treatment for such cases. Ideally, experts view on the same can be taken and accordingly based on the risk involved proper treatment must be given effect to. Further, the same can be intimated to the department for records purpose.

Transactional Restructuring

Optimising the cost of GST transactions would be the need of every business to remain/ get to be competitive. Various options may have to be examined. Re-engineering exercise for those who have been in existence for some time may pay rich returns. Understanding the options of restructuring and choosing the best based on the risk/return criteria maybe necessary. Few illustrative aspects of transactional restructuring are:

- Stocking up or keeping low inventory based on rates of product as on last date;
- Strategising the stock transfers to avoid working capital blockage;
- Breaking a composite supply into multiple different supplies- For Ex: Combos with aerated drinks in restaurants, Cinema halls;
- Merging multiple supplies into a composite supply- For Ex: Vaastu, High Rise Premium to be merged with construction;
- Determining whether a transaction to be restructured as a Composite supply or as a Mixed supply;
- Clear breaking up the Price to optimise taxes;
- Revisiting the Discounts policy- Nature of discount, Cash discount or trade discount, whether linked to invoice or not;
- Security Deposits in *lieu* of advances to ease cash flows;
- Reviewing pricing of all related party vendors to avoid disputes in transaction value- Able to establish arms length; and
- Doing away with the policy of raising Mother Purchase Order's with supplies over a period of time.

This is just an illustrative list, there can be many more aspects to transactional restructuring, therefore a business needs to understand its various business transactions, identify various options of restructuring and apply/implement the same. The entire exercise could be challenging but benefits could accrue from it.

What if Any Transitional Aspect is not Addressed in *GST Laws*?

There are certain transitional aspects which are not addressed in the Model GST law. For instance, Provision for removal of inputs for job-work in the Model law does not explicitly cover direct removal to job worker place from vendor locations and also

it does not cover direct dispatches of inputs by job-worker to the principals customer after processing. There can be many more such practical scenario's which model GST law has not envisaged and hence not covered. Therefore, it poses a challenge on the businesses as to treatment for such cases. Ideally, experts view on the same can be taken and accordingly based on the risk involved proper treatment must be given effect to. Further, the same can be intimated to the department for records purpose.

What if Certain Transitional Aspects are Practically Difficult to Implement?

There can be certain transitional aspects which would be more complex in a practical scenario and there may not be only one view of the same. For instance: Determining the quantum of availing credits based on stock or determining the right pricing for goods/services in the GST regime considering the anti-profiteering measures. In such cases, businesses shall face challenge in selecting the right approach. Further, the approach adopted may easily be contradicted by the department. Therefore, in such scenarios businesses must have proper documents, evidences in place and if possible get the same duly certified by the competent authorities to establish its claim.

Updating of Various *GST Laws* for Each State in a Quick Short Time and Complying with Procedural Aspects of Each State

In embracing a change it becomes crucial for businesses and professionals to stay updated with the change. Government officials are making the laws, revised laws, rules, procedures, formats at good speed. Industry and professionals maybe far behind if law is put in place on April. The revised Model GST Draft has been put up in the public domain on 26th November 2016. Further, upon approval by GST Council, soon each State would come up with its own GST law (to extent allowable) and there set of rules, procedures, etc. One can stay current by having a continuous learning and training system in place. In larger organisations, master trainers must be identified in each department who shall undertake in-depth training of the changes and impart the same downstream.

Determining Right Pricing- *Anti-Profiteering*

Section 169 of the Model GST law specifically states that in case the Input Tax credit in respect of inputs held in stock is taken then the benefit of the same must be passed on to the buyers. It would be crucial for the businesses to quantify the benefit and determine the commensurate reduction in pricing that would be required to off-set the benefit. The consequences of the decisions taken are in the future. The system should be able to face at the time of departmental audits in the GST regime. Therefore, due care needs to be taken under the guidance of the professionals while dealing with such loosely drafted provisions in the law without clear guidance.

Filing of Last Return in Current Tax Regime

Filing of the last return in the current tax regime is the last chance to make good the old problems/decide on difficult issues and start afresh. Based on the GST impact assessment with complete health check of compliances for the last 1 year must be done and the same must be given effect to in the last return. Missed credits, doubtful credits, credits reversed to buy peace *etc.* can now be availed in the last return with proper intimation to the department. Transactions overlapping between the two regimes must be clearly understood and correct legal effect must be given in the old returns. Transactions which can be closed profitably prior to GST could be closed. Once the old returns are filed and the time limit of its revision expires then the chance of making changes is less and only cash refunds under the earlier law would be the only option. Disputed refunds for credit accumulation could lapse.

Filing of First Return in *GST Regime*

The filing of the first return in the GST regime would also be a challenge. Understanding the first return and implementing its filing in a correct manner in a first go shall be a daunting task. However, if not done properly, then it could lead to issues continuing even post-implementation.

Dealing with Unorganised Vendors/ Customers- Can be Obstacle in Smooth Transition

Constant communication with the vendors/ customers and their support is very crucial in

smooth transition. Carrying along the un-organised vendors into the GST regime is a risky affair. Many aspects of the GST regime such as matching concept, compliances *etc.* would ensure that customers would not like to take any risk leading to cash flow issues for the vendor. The task of the vendor evaluation/assessment and their preparedness for the GST is important. It must be assessed well in advance during the transitional phase so that the loose link the chain is not carried along to the GST regime. Vendors who understand can pass on the benefit and ensure that the intermediate supplier is not out of pocket when the customer reduces the prices.

Nature and Extent up to Which ERP System must be Tweaked

Needs of the businesses from ERP could undergo a change in the GST regime. The decision on the nature and extent of the tweaking to the ERP that is required to be done to continue post GST would be the first challenge. It shall be challenging for the businesses to decide whether to totally migrate into the new ERP or to completely overhaul the existing ERPs or to list out the various reports, formats, fields that needs to be changed in the existing ERP. Various factors that may help in determining the same could be: Efficiency of current package, size of business, time for transition to new ERP, time left for GST, support from the ERP vendor, *etc.* Based on these factors, businesses must take a decision as to which immediate changes in the ERP must be done to ensure a smooth flow of operations in the GST with reduced manual efforts on compliance.

Performing GST Impact Analysis

During transition one of the important tasks would be to understand how GST is going to impact your business. Therefore, for that purpose larger businesses need to do the GST impact study and analyse the impact. Further, impact assessment helps in channelising the transitional efforts in the right areas. Various aspects that needs to be considered in the process of impact analysis are:

- Understand self-business first- As-is mapping of the business transactions
- Perform minimum past one year sanity check
- Credit Maximisation, Review of present credits and compliance

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- Performing various ratio analysis to understand the business and its GST impact
- Assess detailed impact on business, individual business transactions and impact on various business departments.
- Proactively mitigate the risks of the negative impact. Enhance the positive impact.
- Implementation not restricted to Finance and Accounts department. readiness and learning equally required by procurement, production, stores, sales and marketing, IT, Admin and HR departments also.
- Businesses acting early on the GST impact to have edge over competitors.

Conclusion

Businesses that do not take care in the initial period would face disputes/demands after 3-4 years of frustration during audit, as they do not have reconciliations, evidence to prove compliance in the transitional phase. Effective GST transition could result in capturing new customers, safeguarding the present market as well as protect the present margin. While it is true that *every challenge is an opportunity*, in early study and for smooth transition, the saying *a stitch in time saves nine* is also important. ■