

Impact of GST on the BPO/KPO Sector



Goods and Service Tax (GST), touted as the biggest tax reform in India, is all set for a roll out effective from 1st July, 2017. The Hon'ble President of India has given his assent on 12th April, 2017 to 4 bills – CGST, IGST, UTGST and GST (Compensation to States) and the next step for the Central Government is to notify the relevant rules and the effective date of enactment. In the meantime, Telangana and Bihar have already ratified the SGST laws and other states are soon expected to follow suite. In the light of the above developments, the BPO/ KPO industry would need to analyse the provisions of the law to understand the impact of GST on its business. Read on to know more...

I. Background on the BPO/KPO Industry:

In India, the BPO/KPO segment is the fastest growing segment of the ITES (Information Technology Enabled Services) industry. India's unique geographic location and the investor friendly tax structure in India have all made the BPO/ KPO industry in India very popular.

What is BPO?

Business process outsourcing (BPO) is the activity of contracting of non-primary business activities and functions to a third-party provider. BPO services include payroll, human resources (HR), accounting and customer/call centre relations etc. Usually, BPO is implemented as a cost-saving measure

for tasks that a company requires but does not depend upon to maintain their position in the marketplace.

Services offered by BPO Companies (illustrative):

- Customer support services
- Technical support services
- Telemarketing services
- IT help desk services
- Insurance processing
- Data entry and data processing
- Data conversion services
- Bookkeeping and Accounting services
- Form processing services
- Online research

What is KPO?

Knowledge process outsourcing (KPO) is a sub-set of BPO and calls for the application of specialised domain pertinent knowledge of a high level. KPO business entities provide typical domain-based processes, advanced analytical skills and business expertise, rather than just process expertise.



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Services offered by KPO Companies (illustrative):

- Engineering services
- Web-application development
- CAD/CAM Applications (Computer-aided design/Computer-aided manufacturing)
- Legal process outsourcing
- Business and market research
- Business and technical analysis
- Content development

While KPO derives its strength from the depth of knowledge, experience and judgment factor; BPO in contrast is more about size, volume and efficiency.

II. Highlights of the GST law:

It is a destination-based single tax on 'supply of goods and services' following the invoice method for credit mechanism as it seeks to consolidate many and different taxes and taxing statutes at the Central and the State level into a single, uniform and comprehensive tax structure. Some highlights of the GST law are provided below:

- Taxable event to be 'supply' as opposed to the varied taxable events under the current indirect tax regime such as 'manufacture', 'sale of goods' or 'provision of service'.
- The GST Council has decided to adopt a 4-rate structure – Lower rate 5%, Standard rates of 12% and 18% and Higher rate 28% apart from zero-rated and exempt supplies. Services are expected to be taxed at 18%.
- Input tax credits would be allowed on all inward supply of goods and services (other than those specifically restricted) including inter-State supplies. In other words, even credit on receipt of goods would be seamlessly available to persons engaged in supply of services, for set-off against their output tax liability.
- The concept of 'centralised registration' would no longer hold good under the GST law as every person effecting taxable supplies in a

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Anti-profiteering measure has been provided for in the GST laws to ensure that the benefits of implementation of GST (such as saving of costs due to seamless credits, minimalised cascading effect of taxes, etc.) are passed on to the end consumer.

state would be liable to obtain registration in every such State, irrespective of the value or volume of transactions undertaken in such States, so long as the PAN-India turnover exceeds ₹20 lakh.

- Supplies without consideration between registrations of same person and between related persons would be taxable based on a value determined by the Valuation Rules.
- Concept and relevance of 'composite supplies' and 'mixed supplies' have been introduced. Composite supplies will be taxable as if the supply is wholly that of the principal goods/services and mixed supplies will be taxable as if it is wholly the supply of those goods/services which attract the highest rate of tax.
- All goods and services received by registered persons from unregistered persons would be liable to GST on reverse charge basis.
- Consideration for supply may be in terms of money or otherwise.
- Matching of credits w.r.t inward supplies of recipient with outward supplies of supplier is mandatory for entitlement of credit in the hands of the recipient.
- Input tax credits availed and utilised for non-business purposes and non-taxable supplies will have to be proportionately reversed.
- Filing of returns is to be undertaken state-wise on a monthly basis.
- Concept of GST Compliance Rating has been introduced where a score is assigned to every registered dealer based on his record of compliance under the Act. A recipient will not be eligible to claim credits from suppliers whose GST compliance rating falls below a threshold limit.
- Anti-profiteering measure has been provided for in the GST laws to ensure that the benefits of implementation of GST (such as saving of costs due to seamless credits, minimalised cascading effect of taxes, etc.) are passed on to the end consumer.

III. Impact:



Taxability:

Largely, the BPO/KPO sector is subject to the levy of service tax only, which is currently 15%. Further, a significant portion of the entities in this sector being engaged in export of services, the exposure to service tax is pretty minimal. Barring a few entities engaged in domestic sales of packaged/canned software, no VAT is paid by these entities.

Currently, software maintenance activities are treated as works contract services and thus liable to service tax on 70% of the receipts in addition to VAT on 75% of the receipts, resulting in approximately 145% tax. Under the GST regime, such a situation would never exist as the supply would be either 'supply of goods' or 'supply of services'.

Rate of Tax:

The GST Council has proposed a 4-rate structure of 5%, 12%, 18% and 28%, apart from zero-rated and exempt supplies. However, the GST Council would take up the fixation of rates for goods and services during its meet on May 18th-19th. Services are expected to be taxed at 18%. This will have a negative impact for entities who are paying only 1 tax i.e. service tax at 15%. However, entities who are currently paying VAT and service tax will be benefited, where the effective rate of tax is between 20 to 22%;

Refunds and Working Capital:

The GST rate on services likely to be pegged at 18%, the entities claiming refund under the GST regime would see a greater cash blockage compared to the existing laws as the input services received by the entities are currently taxed at 15%. This working capital blockage will be far worse for an STPI unit if the upfront exemptions, that the unit was hitherto availing under the existing laws, are withdrawn under the GST regime.

On the plus side, provisional refund of 90% of the refund claim has been provided for in the GST

laws, which mandate a refund order to be passed within 7 days from the date of acknowledgement of refund application. It is for the first time that a time frame for processing of refund claims is being brought in as a statutory provision. Further, the time limit for filing of refund claims is fixed at 2 years from the relevant date, as against the time limit of 1 year under the existing service tax law. It remains to be seen how effective these provisions turn out at the ground level.

Cross Charge:

Cross charges and cost allocations between units of the same entity having separate GST registrations will be treated as 'supply' under the GST regime and will be liable to tax based on the location of the units. While this provision is in line with the consumption-based taxation policy, the cause for concern is the fact that the valuation for such transactions will now have to be determined in line with the valuation rules, which require the open market value to be considered as a general principle. This is sure to open a Pandora's box and will trigger tax disputes.

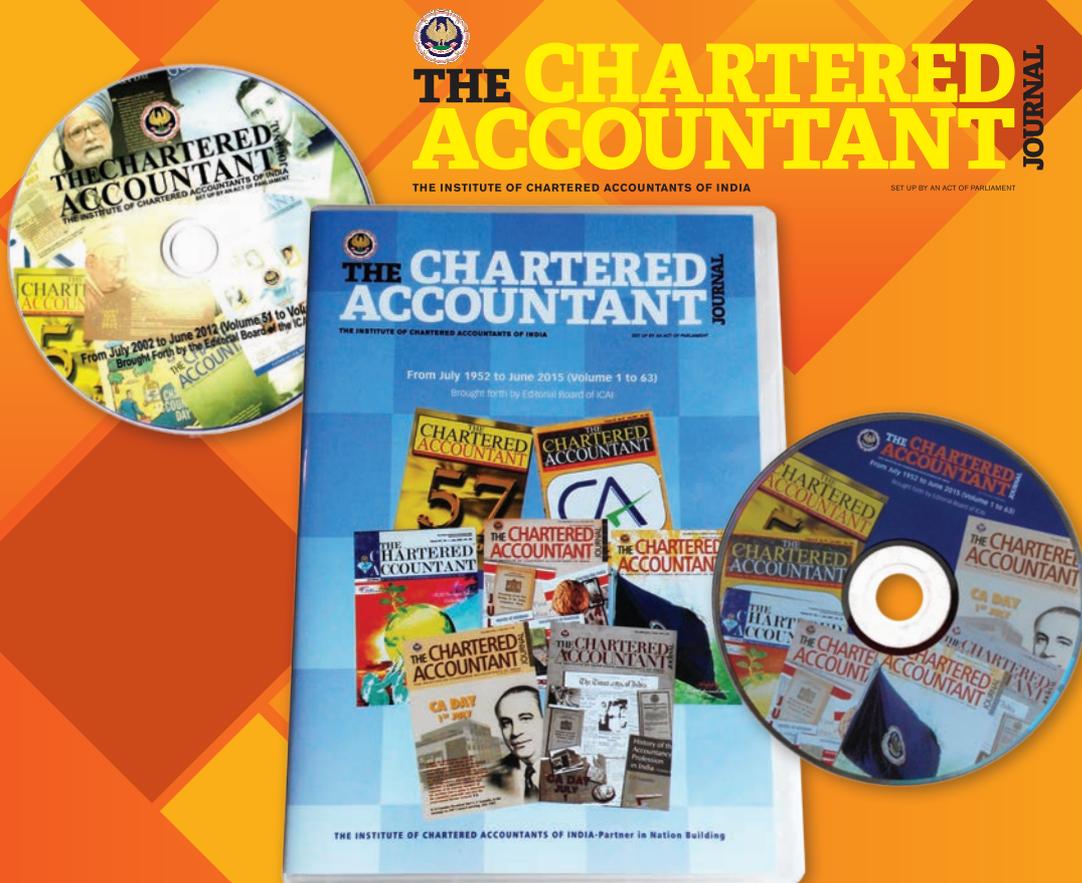
Place of Supply:

The principles for determining 'place of supply' are laid out in Section 10 to Section 14 of the IGST Act. The provisions of place of supply are largely similar to the Place of Provision Rules, 2012 (PoPS) existing under service tax law. Under the GST regime, broadly, the *place of supply of goods* would be the location of the goods at the time of delivery to the recipient and the *place of supply of services* would be the location of the recipient.

BPO/KPO entities usually cater to a wide customer base across India. However, service tax, being a central levy, the need for determination of place of supply in each state of supply did not arise (except identification of whether the services are provided in the taxable territory/non-taxable territory). Going forward, place of supply will have to be determined for every supply effected in order to classify them as intra-State supply (liable to CGST + SGST) or inter-State supply (liable to IGST); as entities will have to charge the appropriate taxes based on the nature of supply.

The importance of identifying the 'place of supply' cannot be undermined and an error in determining the 'place of supply' would lead to payment of

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wrong type of tax. This is of critical importance since payment of wrong type of tax is equal to non-payment of tax itself and the tax wrongly paid has to be claimed as a refund.

Time of Supply:

Section 12 and 13 of the CGST Act lay down the fundamental principles for determination of the time of supply. Under the GST regime, 'time of supply' of services is the earlier of the date of receipt of payment or the date of raising the invoice. Further, supply is deemed to have been made to the extent covered by invoice/payment.

It is relevant to note that in case of continuous supply of services (i.e. services provided continuously for more than 3 months with periodic payment obligations), invoices need to be raised based on the due dates for payment specified in the contract (whether or not received). This will have an adverse impact on working capital of the entity. A more scientific approach would be to identify milestones in the contract, wherever possible, and raise invoices accordingly. This would put to rest the ambiguity of identification of the date of receipt of services, which is a mandatory requirement for claim of input tax credit (in the hands of the customer).

Export of Services:

The concept of export of services is broadly borrowed from the provisions of the current Service Tax law. Under the GST regime, Export of service will be treated as 'zero-rated supplies'. Accordingly, while no tax would be payable on such supplies, the exporter will be eligible to claim the corresponding input tax credits. It is relevant to note that the input tax credits would be available to an exporter even if the supplies were exempt supplies as long as the eligibility of the input taxes as input tax credits is established.

The exporter will be eligible to claim refund under the following situations:

- He may export the services under a Letter of Undertaking, without payment of IGST and claim refund of unutilised input tax credit; or
- He may export the services upon payment of IGST and claim refund of such tax paid.

Therefore, the BPO/ KPO sector would largely be able to claim refund on the exports effected on similar lines with the existing provisions. However, depending on the rate of tax for the inputs, input

The term 'input tax credit' has a wider meaning compared to the existing laws and means tax paid on goods or services or both used in the course or furtherance of business, and includes tax paid on reverse charge basis.

services and capital goods, the impact on working capital will have to be determined. Provisional refund of 90% of the refund claim within 7 days of date of acknowledgement is also provided for, which comes as a relief.

SEZ/STP:

Supplies made to or by a SEZ unit/developer will be treated as an inter-State supply under the GST law in terms of Section 7(5) (b) of the IGST Act, 2017. Further, supplies made to SEZ unit/developer will be treated as zero-rated supplies. Therefore, the SEZ unit/developer operations are expected to continue under the GST era also without hic-cups.

All upfront exemptions are expected to be discontinued under the GST regime. In turn, the units will be entitled to claim refund of taxes paid to the extent attributable to exports. In this breath, it is relevant to note that, refund of unutilised credits is expected to be made available to exporters as a whole and as such, STPI units will not be provided with special exemptions under the GST law. This will definitely have an adverse impact on the fresh registrations under the STPI scheme and the existing STPI units may opt out of the STPI scheme after undertaking a thorough cost-benefit analysis of compliances, additional benefits etc.

Input Tax Credit:

The term 'input tax credit' has a wider meaning compared to the existing laws and means tax paid on goods or services or both used in the course or furtherance of business, and includes tax paid on reverse charge basis. However, input tax restrictions (as prevalent in the existing laws) will continue like food and beverages, outdoor catering, insurance, rent-a-cab (critical to the BPO/KPO industry) and other staff related expenditure.

A major positive to the BPO/ KPO entities under the GST regime, would be the availability of credit on inputs used in the business. Currently, the service providers are not permitted to claim VAT credits on the inputs purchased. Under the GST regime, these

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entities would be entitled to claim input tax credit on all eligible goods and services, alike. Considering the huge investment made by such entities on computers, software packages, furniture, etc., the benefit of input tax credit in respect of goods would be significant.

In a major step to ensure compliance and plugging the loopholes in the existing tax system, 4 cumulative preliminary conditions for claim of credit have been prescribed:

- The recipient should possess a tax invoice/ other tax paying document;
- The recipient should have received the goods or services;
- Tax on the supply of goods or services have been remitted to the Government, either by cash or credit (This has brought the onus of ensuring payment of tax on the supply on the recipient by means of a matching principle);
- The receiver has filed valid returns.

The new condition prescribed for entitlement of credits i.e. the receipt of goods/services, will toss up many issues. Service being an intangible activity, the determination of stage of completion of services would prove extremely difficult. Further, in the case of supply of software, licensing, AMCs etc. where the service is received continuously over a period of time but the payments are released based on timelines agreed in the contract, it would prove extremely difficult to prove that the said services have been received.



Under the GST regime, IGST credit can be distributed as IGST/CGST, CGST credit as CGST/IGST and SGST credit as SGST/IGST only, among the eligible recipients. This can be used by the entities to their benefit to distribute credits among their development centres. The entities must exercise caution to ensure that these provisions are applied to common input services only and the credits distributed thereon do not exceed the available credits.

Further, the recipient of service is burdened with the responsibility of ensuring that the tax on the inward supply effected by him (on which input tax credit is claimed) has been remitted with the department. This would mean the recipient has to validate the fact that tax has been remitted, every single time he is desirous of claiming input tax credit. Considering the volume of transactions and the timelines prescribed for the returns, it would be extremely strenuous on the recipient to ensure the same.

Where the contract with customer provides for recovery of certain expenses like rent-a-cab, etc., the recoveries made by the supplier will be included in the transaction value in the hands of the supplier while discharging tax. It remains to be seen whether such inputs, which are in-eligible in terms of Section 17(5) of the Act, will be eligible as credit as they are subjected to output tax by way of inclusion in the transaction value.

Input Service Distributor (ISD):

Certain services, used commonly by few units of the entity located in different locations, are usually billed at the head office itself like auditor fees, professional fees etc. In such a case, the head office is not eligible to claim credit to the extent it relates to the other units and the head office will have to obtain an ISD registration to distribute the credit to the relevant offices to whom the credit pertains to, in a proportionate manner. It is relevant to note that the concept of ISD will gain immense importance in the GST regime *vis-à-vis* the existing laws, since the concept of centralised registration is done away with. Therefore, if credits relating to units in Chennai and Hyderabad are billed to the head office in Bangalore, the Bangalore unit will have to obtain ISD registration to distribute the credits to such units under a cover of an ISD invoice as the units in Chennai and Hyderabad will be treated as distinct persons under the GST regime.

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The entities must exercise caution to ensure that these provisions are applied to common input services only and the credits distributed thereon do not exceed the available credits.

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Registration:

Every supplier is liable to obtain registration under the Act in the State from which he makes a taxable supply of goods or services or both if the aggregate turnover of the person breaches the threshold limit of ₹20 lakh (₹10 lakh in special category States). Hence, entities will now require to obtain registration in each State where supplies are being effected.

This will increase the compliance cost of the entity as the compliances will now move from a centralised system to a more comprehensive decentralised system. Presently, under the service tax law, a service provider is permitted to obtain a single centralised registration (in respect of businesses across India) provided they have centralised accounting and billing. The units of the entity, spread across India, are to be declared as an additional place of business. This option largely opted for by entities in this sector, will not be available henceforth, as going forward, State-wise registration will be mandatory.

Returns:

Separate State-wise registrations, being a requirement of law, would necessitate that many number of returns to be filed by the units of the entity located in various States. Apart from the monthly returns that are mandated under the GST law, annual return and ISD return will also be required to be filed. The monthly return to be filed by a person in Form GSTR-3 (by 20th of the succeeding month) is further broken down into Form GSTR-1: Details of outward supply (to be filed by 10th of the succeeding month) and Form GSTR-2: Details of inward supply (to be filed by 15th of the succeeding month).

For E.g.: ABC Technologies, operating from 8 states in India is currently required to file 2 service tax returns annually (half yearly basis). Under the GST

Every supplier is liable to obtain registration under the Act in the State from which he makes a taxable supply of goods or services or both if the aggregate turnover of the person breaches the threshold limit of ₹ 20 lakh (Rs.10 lakh in special category States). Hence, entities will now require to obtain registration in each State where supplies are being effected.

Apart from the monthly returns that are mandated under the GST law, annual return and ISD return will also be required to be filed. The monthly return to be filed by a person in Form GSTR-3 (by 20th of the succeeding month) is further broken down into Form GSTR-1: Details of outward supply (to be filed by 10th of the succeeding month) and Form GSTR-2: Details of inward supply (to be filed by 15th of the succeeding month).

regime, ABC Technologies will have to file the following returns:

- 96 monthly returns (12 returns in a year in 8 states)
- 8 annual returns (1 per registration)
- 1 ISD return (assuming 1 unit has ISD registration)

The compliance costs involved in filing of the returns are thus expected to increase. Requirement of uploading the invoice-level details on a monthly basis, which is heavily cumbersome, is an added responsibility on the person filing the returns which warrants the entities to have a robust IT framework and a qualified team to cater to the return requirements.

Invoicing:

As discussed above, the invoicing pattern of the entities will have to undergo a radical change to provide for charging the appropriate tax i.e. CGST + SGST (on intra-State supply) and IGST (on inter-State supply) at every stage of raising the invoice. Further, the GST law mandates the maintenance of a consecutive number for all the invoices raised by one entity under a single registration.

Inward supplies effected from un-registered persons would be liable to tax under Reverse Charge Mechanism (RCM); thus, entities will have to issue a tax invoice in such cases also. This is a huge deviation from the current service tax law where only services were liable to tax under RCM based on the nature of service only and not based on the registration status of the supplier.

Reverse Charge Mechanism (RCM):

The concept of reverse charge mechanism (where the recipient is liable to pay tax instead of the supplier) is already present in the service tax law and under the State VAT laws, albeit slightly on a different footing.

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While the State VAT laws levy such tax on all purchases from un-registered dealers, the service tax laws have notified certain categories of services that will be liable to tax under reverse charge mechanism in the hands of the recipient even if received from a registered service provider.

This is set to change under the GST law where all inward supplies, irrespective of the category of supply, would be liable to tax on RCM basis if procured from an unregistered dealer. This would mean housekeeping services, maintenance service etc. if procured from an unregistered dealer would be liable to GST in the hands of the recipient. In addition to the above, certain category of supplies would be notified as supplies liable to tax under RCM basis irrespective of the registration status of the supplier like legal services, supply of manpower etc. It is expected that the supplies notified would be on similar lines with the notified services under the existing service tax law like legal services, supply of manpower, payments made to government authorities etc.

Notably, being a service-oriented industry, manpower is the backbone of the BPO/KPO sector. Manpower supply services are currently liable to tax under RCM, if procured from an individual, HUF, partnership firm and AOP. BPO/KPO entities resorting to contracting with recruitment agencies like PRC (Professional Recruitment Agency) for supply of manpower can continue to do so under the GST regime without any additional concerns as such transactions are expected to remain outside the ambit of RCM even under the GST regime, since PRC is a Company.

Transitional Issues:

The transitional provisions play a vital role in transiting from the existing VAT/Excise/Service Tax laws to the GST regime. Primarily, no transitional credit will be allowed if:

- The said credits are not eligible under the GST law; and
- The returns under the existing laws are not furnished for the last 6 months

No tax is payable under the GST regime to the extent tax is leviable on services under the existing laws. Further, all refunds pertaining to taxes paid under existing laws would be processed and disposed as per the provisions of existing laws itself. Any refund found eligible would be paid in cash and if any refund is fully or partially rejected, such amount of



claim shall stand lapsed. Appeals in relation to such rejection will be disposed under the existing laws itself. Pending refund balances cannot be carried forward as credit under the GST law at any cost.

IT Infrastructure:

IT infrastructure is one of the basic requirements for successful implementation of Goods and Services tax and it should be well in place before the implementation of GST in India.

At present, the e-filing of returns (and forms w.r.t. State laws) under VAT, excise duty and service tax laws is a bitter experience for the taxpayers, especially around the due dates. This is despite the fact that invoice level details are not a mandatory requirement, which is a requisite under the GST law.

Further, input tax credit is available to the recipient based on pull-push mechanism only, thus requiring monitoring the details furnished by the supplier, probably on a real-time basis. Considering the volume of transactions, invoice level details that need to be uploaded, reconciliations required etc., a robust IT Infrastructure would be a basic necessity.

IV. Conclusion:

There is a lot of expectation from the BPO/KPO industry that the new indirect tax reform will iron out the issues faced in the current tax regime and a new simplified tax regime will be ushered in. While the law has come a long way from the Model GST law released in June 2016 with a promise of a simpler, uniform and efficient tax system, the concerns of the industry are primarily directed towards impact on working capital, increased compliance costs, sanction of refund claims and IT infrastructure costs. ■