Impact of Goods and Services Tax on Aviation Sector – Some Important Issues

The implementation of Goods and Services Tax ("GST"), effective July 1, 2017, as an indirect tax in India has affected almost every major and most minor business sector of the country. Indian aviation is one such industry which has been affected with the GST implementation. Indian aviation industry has been one of the fastest-growing aviation industries in the world. In this GST regime, aviation industry is facing various issues like ambiguity in respect of definition of 'continuous journey', 'stop over', inclusion of 'Aviation Turbine Fuel' ("ATF") and 'Reimport of aircraft & its parts'. Aviation sector is very dynamic in nature and somewhat adversely impacted under GST regime. Read on…

The aviation sector plays a vital role in the infrastructure and economic development of any country. The growth of any industry depends on the economic policy and among others, the taxation system of that country. This sector is covered under multiple taxation systems like GST, Custom Duty, Central Excise, VAT / CS, etc. A significant part of this industry spreads its wings beyond international borders. The orderly development of this sector requires not only international consensus but a fairly easy to understand and easy to comply, internationally competitive taxation system. During the implementation of GST, the Government of India has tried to boost the sector in the right direction. However, the stakeholders still find certain legal hurdles that may warrant further deliberations.

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Following are few important issues that majorly impact aviation industries:

Sr. No.	Particulars	Comments
1	Changes in rates	◆ The applicable rate of GST on Passenger Transportation Service – Economy Class – 5% & Business Class – 12%.
2	Purchase of aircraft through purchase option	◆ The import of aircraft through purchase option was exempt from payment of Basic Customs Duty (BCD), Counter Vailing Duty (CVD) & Special Additional Duty (SAD). ◆ Under GST regime, it is taxable @ 5%.
3	Aircraft Leasing	◆ There are various types of lease arrangements viz. Hire purchase, Finance lease / capital lease, Operating lease, Wet lease, Dry lease. ◆ The taxability of leasing arrangement is different in each case. ◆ It should be noted that Hire Purchase arrangements are also undertaken in aviation sector, however with the repeal of the Hire Purchase Act, 1972 with The Hire Purchase (Repeal) Act, 2005 the legal remedies in relation to hire purchase transactions could become complex and may need to be addressed with due consideration.
4	Payment of Principal & Interest to the Banks & NBFC under Finance/ Capital Lease	◆ In the Pre-GST Regime, Service tax was levied @ 15% on 10% value of interest amount. ◆ Under GST Regime, GST is applicable on the full interest amount.
5	MRO - Reimport of aircraft & its parts	◆ In the Pre-GST Regime, MRO of aircraft undertaken outside India was not liable to service tax. ◆ Under GST Regime, the IGST would not applicable since place of supply is outside India.
6	International cargo services	◆ In the Pre-GST Regime, it was treated as 'export of services'. ◆ Under GST Regime, it is treated as 'exempted services' unless its conditions of exports.
7	Stock Transfer of Consumables	◆ In the Pre-GST regime, Inter-state stock transfer of consumable inventory was not liable to VAT/ CST (subject to submission of declaration forms). ◆ Under GST regime, any inter-state stock transfer is liable to GST.

1. Changes in the Rates

Following are the GST rates and conditions applicable on the services (Reference notification no. 11/2017 -Central Tax (Rate) dated 28th June, 2017):

Category of Service	Description of Services	Pre-GST Regime Rate (Effective Rate)	GST Regime (GST Rate)	Conditions
Passenger Transportation Service – Economy Class	Transport of passengers, with or without accompanied belongings, by air in economy class	6%	5%	Input Tax Credit (ITC) charged on goods used in supplying the service cannot be availed [Please refer to *Explanation* no. (iv)] This condition was also there in Pre-GST regime.

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Passenger Transportation Service– Business Class	Transport of passengers by air, with or without accompanied belongings, in other than economy class.	9%	12%	-
Passenger Transportation Service	Transport of passengers with or without accompanied belongings, by air, embarking from or terminating in an airport located in the state of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram Nagaland, Sikkim, or Tripura or at Bagdogra located in West Bengal.	NIL	NIL	-
Cargo Transportation Service	Goods transport services other than (i), (ii), (iii) and (iv) above.	15%	18%	-

The change in GST rates has impacted the cost of travels. Though the flights ticket prices have not much changed for the economy class travellers due to the minor reduction in rates, the business class travellers are certainly seeing a noticeable difference in their ticket costs after GST. Increase in the rate of tax will increase the cost of air travel for passengers not registered under GST, since they are not eligible for ITC.

2. Purchase of Aircraft through Purchase Option

Every airline company's fleet comprises of aircraft taken on purchase or lease. The aircraft is classified under HSN code 8802. The purchase / import of aircraft attracts 5% IGST.

In the Pre-GST regime, import of aircraft through purchase option was exempt from payment of Basic Customs Duty (BCD), Counter Vailing Duty (CVD) and Special Additional Duty (SAD). Under GST regime, the ITC on account of purchase / imports of aircraft is restricted in the case of economy class because of condition mentioned in above point number 1.

Category of Service	Description	Pre-GST Regime Rate (Effective Rate)	GST Regime GST Rate
Import/ Purchase of aircraft	Import of aircraft	BCD-NIL, CVD – NIL, SAD-NIL (Subject to satisfaction of conditions mentioned under NN.12/2012)	BCD- NIL, IGST-5% (Subject to satisfaction of conditions mentioned under #535 NN.50/2017)

Under GST regime, CVD and SAD are subsumed under GST. It forms part of cost to the airlines because of the following reasons:

a) CVD and SAD was exempted under Pre-GST regime.

b) ITC Credit on Inputs is restricted in the case of economy class.

3. Aircraft Leasing:

Almost all airline companies procure / import aircraft and its parts from other airline or leasing entities for the following reasons, among others:

a) operate aircraft without any financial burden of buying them;

b) spread the operating cost over the term of the lease; and

c) Provide temporary increase in capacity.

Where import is on lease basis, IGST on import is exempted on the condition that IGST is paid as import of services under para 1(b) or 5(f) of schedule II to CGST Act. The airline may consider any of the following arrangements:

a) Hire purchase
b) Finance lease / capital lease
c) Operating lease
d) Wet lease
e) Dry lease

Type of Lease	Description of Lease	Pre-GST Regime Rate	GST Regime GST Rate	Remarks
Hire purchase	In this option, the aircraft is bought gradually viz. the hire purchaser effects regular payments (while enjoying its use) until the full price is paid and the aircraft is purchased at the end of the term of the hire purchase.	VAT/CST (Deemed Sale)	5%	- The VAT/CST rate varies from the state to state. - Under GST regime, goods purchase on hire considered as supply of goods. [Refer Sch-II –Sr. No.1(c) of the CGST Act, 2017]
Finance lease / Capital lease	In finance lease, there is a substantial transfer of all the risks and rewards of ownership to the lessee. It will generally run for more than the full economic life of the asset. Basically, this means that the lessee is in a broadly similar position as if they had bought the asset.	BCD - NIL, CVD – NIL SAD - NIL (Subject to satisfaction of conditions mentioned under NN.12/2012)	BCD - NIL, GST - 5% (Subject to satisfaction of conditions mentioned under #547 NN.50/2017 as amended by NN.65/2017)	- Under GST regime, the aircraft procure on finance lease is considered as supply of goods [Refer Schedule II–Sr. No.1(a) and 1(c) of the CGST Act, 2017] - IGST would be liable to pay at the time of import. - Under aircraft Finance lease arrangements, the ownership generally gets transferred at the end of the lease term at the option of the lessee and thus transaction could get covered under Sr. No.1(c) of Schedule II of the CGST Act, 2017. Accordingly, IGST would be applicable @ 5% under reverse charge mechanism. However, this amounts to double taxation since there is no specific exemption in the notifications issued under CGST/ IGST Act for the same.

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SCHEME PERFORMANCE SUMMARY

Aditya Birla Sun Life Tax Relief '96 - Regular Plan - Growth Option

NAV as on January 31, 2019: ₹ 30.22

Fund Manager: Mr. Ajay Garg (Since October, 2006)

Particluars	CAGR % Returns			
	1 Year	3 Years	5 Years	Since Inception
Aditya Birla Sun Life Tax Relief '96	-5.47	13.55	19.61	24.27
B: S&P BSE 200 TRI	-3.38	14.32	15.11	12.81
AB: Nifty 50 TRI	-0.35	14.20	13.61	12.65
Value of ₹ 10,000 invested				
Aditya Birla Sun Life Tax Relief '96	9,453	14,656	24,489	14,34,141
B: S&P BSE 200 TRI	9,662	14,957	20,216	1,57,183
AB: Nifty 50 TRI	9,965	14,910	18,930	1,52,272
Inception Date: March 29, 1996				

Past performance may or may not be sustained in future. The above scheme performance is of Regular Plan - Growth Option. Kindly note that different plans have different expense structure. Load and Taxes are not considered for computation of returns. The scheme is in existence for more than 5 years. When scheme/additional benchmark returns are not available, they have not been shown. Mr. Ajay Garg manages 4 open-ended schemes of Aditya Birla Sun Life Mutual Fund. The scheme is currently managed by Mr. Ajay Garg since October 01, 2006 (12.4) years. All dividends declared prior to the splitting of the scheme on March 06, 2008 into Dividend & Growth options are assumed to be reinvested in the units of the scheme at the prevailing NAV (ex-dividend NAV).

PERFORMANCE OF OTHER OPEN-ENDED SCHEMES MANAGED BY SAME FUND MANAGER

Fund Manager: Mr. Ajay Garg

Scheme Name's	CAGR % Returns					
	1 year		3 years		5 years	
	Scheme	Benchmark	Scheme	Benchmark	Scheme	Benchmark
Aditya Birla Sun Life Tax Plan	-6.12	2.06	12.95	14.86	18.81	13.60
Aditya Birla Sun Life MNC Fund	-4.15	-8.01	10.01	17.12	21.88	19.60
Aditya Birla Sun Life Index Fund	-1.69	-0.35	12.63	14.20	12.14	13.61

Note:

a. Mr. Ajay Garg manages 4 open-ended schemes of Aditya Birla Sun Life Mutual Fund.

b. Different plans shall have a different expense structure. The performance details provided herein are of Regular Plan - Growth Option.

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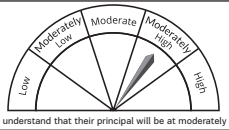
Aditya Birla Sun Life Tax Relief '96 (An open-ended equitylinked saving scheme with a statutory lock in of 3 years and tax benefit)	• long term capital growth • investments in equity and equity related securities, with tax benefit under section 80C, subject to eligibility	 Investors understand that their principal will be at moderately high risk

***Investors should consult their financial advisors if in doubt about whether the product is suitable for them.**

Note: Performance as on January 31, 2019

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Type of Lease	Description of Lease	Pre-GST Regime Rate	GST Regime GST Rate	Remarks
Operating lease	An operating lease does not transfer substantially all of the risks and rewards of ownership to the lessee. It will generally run for less than the full economic life of the asset.	Service tax - 15% (If the agreement entered and executed in India)	GST - 5%	- Under Pre-GST regime, if the lease agreement of an aircraft is entered into and executed outside India and the situs of such transaction is outside India, then it was not liable to VAT and service tax in India - However, under GST regime, it is taxable irrespective of the place where the agreement is entered into and executed. It is the supply of services [Refer Schedule II –Sr. No. 5(f) of the CGST Act, 2017] - There is no GST on import of the aircraft. However; GST would be levied on periodic lease rentals.
Wet lease	A wet lease is an arrangement whereby one airline (lessor) provides an Aircraft, Crew, Maintenance, and Insurance (ACMI) to another airline (lessee). The payment terms are mostly on Power By Hour Rate ("PBTH") basis.	Service tax - 15% (If the agreement entered and executed in India)	GST - 5%	- Same as stated in operating lease - Under Pre-GST regime, in case aircraft touches Indian air space, then Service Tax was applicable - However under GST regime, the place where aircraft fly does not matter.
Dry lease	A dry lease is a leasing arrangement whereby an aircraft financing entity (lessor) provides an aircraft without crew, ground staff etc.	VAT/ CST	GST - 5%	- Same as stated in operating lease - Under Pre-GST regime, the taxability depended on the situs of goods and whether transaction falls in the "deemed sales" category.

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4. Payment of Principal and Interest to the Banks and NBFC under Finance/ Capital Lease

As mentioned above, in finance lease, there is a substantial transfer of all the risks and rewards of ownership to the lessee. A capital lease involves the transfer of ownership rights to the asset to the lessee. The lease is considered a loan (debt financing), and interest payments are expensed on the income statement. A finance lease is a method of borrowing against the asset. The interest represents the time value of the money expended by the bank in financing the asset.

Type of payment	Pre-GST regime	GST regime	Remarks
Payment of principal amount	- Not liable to service tax. - Payment of principal amount was considered as 'transaction in money', hence not considered as 'service'	- Not liable to GST. - Payment of principal amount does not fall within the definition of 'supply'.	-
Payment of interest amount	Service tax was levied on 10% of interest amount.	GST applicable on full interest amount.	- Services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount (other than interest involved in credit card services) is exempt. - However, in a financial lease, the ownership of the asset is with the bank. In essence, it is a 'purchase the asset and lend it further' transaction for bank. - Therefore, neither the services are purely in the nature of extending loans nor the consideration for a financial lease is purely in the nature of interest. - Thus, interest on finance lease transactions will be taxable under GST.

5. MRO - Reimport of Aircraft and Its Parts

As per the DGCA's guidelines, airline are required to maintain the aircraft in an airworthy condition for which the airline sends the aircraft and its parts (usually) outside India for Maintenance, Repair & Overhaul ('MRO') services. In the Pre-GST regime, MRO of aircraft undertaken outside India was not liable to service tax in the hands of the recipient carrier, since the place of supply (place of performance of services) was outside India.

In the GST regime, as per the entry 3 of Schedule II of the CGST Act, 2017 the repair of aircraft and its parts is treated as 'supply of services'. Accordingly, MRO activities would fall within the scope of above-mentioned entry. In respect of MRO of aircraft undertaken outside India, the place of supply is outside India. (Refer Section 13 (3) (a) of the IGST Act, 2017). However, customs authorities deny the same and charge customs duties & IGST on the same. Though the credit of GST paid is available, such levy entails additional cash flow burden on airlines, since the ITC is restricted to the extent of economy class.

However, later on exemption has been granted vide NN-38/2017-Cus dated 30th June 2017, that Reimport of aircraft & its parts would not be liable for the custom duties.

6. International Cargo Services

In the Pre-GST regime, the situs of taxation for international cargo service was the place of supply (destination based). Since the location was outside India, the same was considered as 'export of services' subject to fulfillment of export conditions as per Rule 6A of the Service Tax Rules, 1994.

Under GST regime, the place of supply is divided into two categories viz.

a) Where location of the Service Provider ('SP') **and** location of the Service Recipient ('SR') is located in India i.e. Section 12 of the IGST Act, 2017.

b) Where location of the Service Provider ('SP') **or** location of the Service Recipient ('SR') is located outside India i.e. Section 13 of the IGST Act, 2017.

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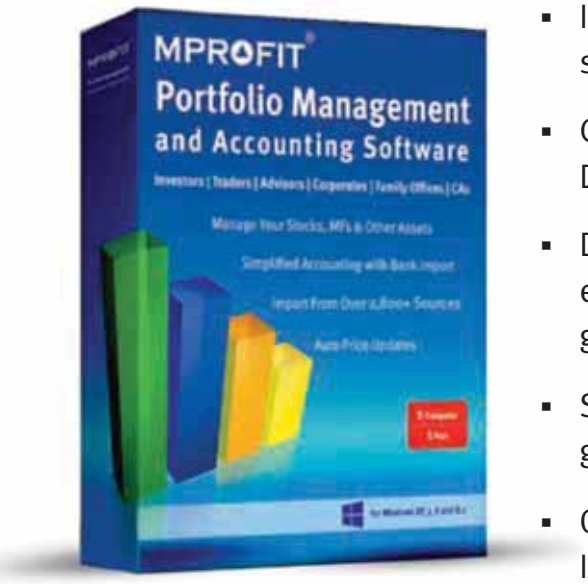

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In the case of (b), the international cargo service is treated as 'export of service' subject to fulfillment of export conditions. However, in case of (a), in the initial period, it was taxable supply i.e. not treated as export of services, since place of supply was India.

After various representations made by the aviation sector, effective 25th January, 2018, the Central Government has exempted services by way of transportation of goods by an aircraft from customs station of clearance in India to a place outside India. (Refer Notification No. 2/2018 - Integrated Tax (Rate) dated 25 January 2018).The same exemption is extended till the 30th September, 2019. The implications of above notification are given below:

- International cargo service [Covered in point (a) above] is treated as 'exempted services' instead of taxable service.
- Airlines shall be required to reverse ITC in respect of the exempted services.
- The input tax credit which is exclusively attributable to the provision of international cargo services which qualify as export or zero-rated supplies shall be fully eligible.
- However, input tax credit which is exclusively attributable to Transport of Goods by Air (TGA) services which do not qualify as export or zero-rated supplies and are considered as exempt supplies, shall be fully ineligible and required to be reversed.
- Reversal of ITC as per the Rule 42 and 43 of the CGST Rules, 2017.

However, Integrated Goods and Services Tax (Amendment) Act, 2018 dated 29th August, 2018 (effective from 1st February, 2019), amended section 12(8) to insert a proviso that where the transportation of goods (by mail or courier) is to a place outside India, the place of supply shall be the place of destination of such goods. Therefore, transportation of goods to a place outside India would either qualify as exports if all the conditions of export are met, or not taxable because the place of supply is falling outside India.

7. Stock Transfer of Consumables

In the Pre-GST regime, Inter-state stock transfer of consumable inventory, was not liable to any tax subject to submission of declaration forms.

Under GST regime, the inter-state stock transfer is liable to GST. The following are the challenges with respect to inter-state stock transfer of goods:

- ITC of GST paid on stock transfer is available, thereby raising cash flow concern for airlines.
- Valuation of stock transfer will be an additional challenge for airlines, since value declared in the invoice shall not accepted as open market value since recipient branch is not eligible for full ITC (refer 2nd proviso to Rule 28 of the CGST Rules, 2017).

Under the GST regime, in the case of transportation of passengers by economy class, ITC charged on goods used in supplying the service cannot be taken. However, in case of stock transfer of goods, airline can avail 100% credit of ITC paid on the stock procurements since airline effects the stock transfer of goods and does not use the same for passenger transportation services. There should be co-relation between stock procurement and its stock transfer in order to avail 100% ITC.

The Challenges

The aviation sector despite being covered by the provisions of GST Law, attracts a host of other taxation systems prevalent in our country viz., customs duty, central excise duty, value added tax, municipal taxes etc. This entails not only a huge tax burden and results in cascading effect whereas the compliance requirements also get added on. Thus, one may infer that post-GST implementation; the challenges have become all the more challenging.

The category of services which this sector provides can be broadly classified into two parts namely— passenger traffic and cargo traffic. However, on the inward side, this sector utilizes services or goods or both viz., ATF, airspace, airports, communication systems, repairs and maintenance, security services, purchase of equipment, leasing services, human resources, back office services and host of other incidental and ancillary services both at domestic and international levels. This gamut of inward and outward supplies coupled with national and International taxation systems creates a maze of issues while understanding the cost-benefit analysis for an airline company, specifically on account of the fierce competition. As such, the Government of India is required to create a conducive taxation system which provides a positive fillip to the domestic aviation industry.

Suggestions

(1) The multi-location registration requirement under GST has not only made the compliances difficult but has entailed blockage of working capital in terms of levy of GST on transfer of goods and services between units that creates a dent on the economy of an airline company.

(2) On the lines of the recommendation of OECD's International VAT/ GST Guidelines, the aviation industry may be allowed imports free of customs duties and exports may be zero rated with all types of tax credits.

(3) That the government may bring ATF in the GST regime so that the taxes paid thereon may become creditable.

(4) That the valuation provisions, as much as, imports, exports, various kind of leasing and MRO services requires clarification. ■

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2. https://www.wikipedia.org

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