Common Errors while transitioning into GST

One of the most important aspects that a registered taxable person must understand while ushering in the GST regime would be aspects relating to transition. This paper attempts to list down some representative crucial issues that one needs to bear in mind while transitioning into the GST regime. Caution must be exercised by every person who transits into the new regime while bearing in mind the nature of business, the type / class of goods and / or services, the nature of tax etc., while transitioning. While this paper attempts to bring out several issues it may not address each issue of every business. This paper only stimulates debate while business being dynamic has to address each of the issues keeping the GST laws in mind.

1. **Registration of multiple locations**

   'Place of business' and 'place of supply' are two completely different terms that are very often understood interchangeably. Registration is required in respect of the 'place of business' and not the 'place of supply'. For example, a registered person may be engaged in renting of immovable property and carries on his 'business' from his Office and not from the 'location' of property let-out. Unless this distinction is truly appreciated, it would be impossible to recognize the registration requirement. Of course, the migration process demands that all current registration/s to be migrated, but the Registration Rules provide for deregistration of places that will not require staying registered in GST regime.

   Registration is, therefore, not a mundane task that can be left to any delegate to carry out, but demands careful consideration to select the nature and location in which it is to be obtained. Goods and Services Tax is a destination-based tax and therefore registrations currently obtained under an origin-based tax regime are bound to be outdated.

   Routinely migrating into GST will only mean that the paradigm shift in the basic framework of tax regime (before-after) may not have been fully appreciated. Here's where one could go wrong. For example, a manufacturer in Tamil Nadu has set-up depots in Andhra Pradesh and Karnataka currently

and on an average Rs.10 crores worth of inventory is maintained at these depots. The purpose of these depots would be to save 2% CST payable on inter-State sales which is not creditable down the line. Now, if these depots were to continue in GST regime, inter-State stock transfers would attract IGST at (say) 12% or 18% making the entire depot-model unviable. Of course, it would be available as credit to the depot, but remember depots hold Rs.10 crores as stocks throughout the year. So therefore, catering to the market in Andhra Pradesh and Karnataka when the factory is in Tamil Nadu needs to be re-examined by moving those depots inside Tamil Nadu but within short distance to reach the market. For those familiar with local geography, Vellore would be a good location for a depot to cater to Andhra Pradesh market and Hosur for Karnataka market and if need be, Coimbatore for Kerala market. These new depot locations are within Tamil Nadu so that there is no GST applicable on transfer of stock from factory to depot. And these depots are close to the target market to cater to. The short-point from this long illustration is that many aspects of the current tax regime will be outdated and these demands, rethinking about the new go-to-market plan. Looking at the GST registrations obtained will showcase whether the planning has been done well or not.

2. Review of Past Cases

Most on-going litigations can be classified into:

- Statutory Forms related matters (CST)
- Reverse charge matters (Service Tax)
- Classification-Valuation matters (Excise-Service Tax)
- Procedural non-compliance matters (All Laws)
- Input / Output tax related matters (All Laws)

As a general rule, success in current litigation will be subdued as these rulings will not provide any precedence value for the future, because the law is being changed. The interpretation of law or selection of its application to the tax payer's facts will not have any further shelf-life. So, all on-going litigation needs to be reconsidered in the light of this fact. After giving careful consideration to all pending matters, a tax payer may see that there may not be any merit in continuing some of them. With this general observation, two specific kinds of pending litigations can be examined, namely:

- Reverse charge matters – Where the demands, if paid, are eligible to Cenvat credit entails a dilemma where in case an adverse decision were to be delivered (after appointed date), the service tax would be payable without any credit or refund or transition because the opportunity has passed after 60 days from appointed date. And however, sound, the arguments in defense are in the matter, surely it is no one's case that higher Courts are free from pro-revenue leanings. And if the probability of

such a pro-revenue leaning is say - more that 10%, it does not justify carrying the risk of a confirmed demand without relief of credit or transition. Hence, it may be advisable to consider making payment of the demand and claiming credit which will transition into GST but continue with the litigation on interest / penalty.

- Statutory forms – which are required to be issued quarterly by the customer uploading the corresponding sales but are still pending on appointed date. And especially if the forms are long-pending, the appeal filed may be merely to gain time without any rigorous effort underway to ensure recovery of the forms. With the imminent change in the Office-Officer under the current law, it is even less likely that the forms can be procured if the pending cases are continued. Given the accumulating interest burden, it may be prudent to consider paying-up the demand on long-outstanding forms.

Transition into GST cannot be attempted by leaving aside the pending litigation from the scope of any transition exercise. Thus, it would be fair and just to state that pending litigation matters need to be sanitized before one moves into the GST regime.

3. Transition Credits

It is well understood that closing balance of credits (Cenvat or VAT) will transition seamlessly into GST. But, this seamlessness demands a relook into – what is the closing balance comprised of – to know the merits. It must be conceded that tax payers have accumulated credit balance without being diligent in giving effect to the following:

- Reversal required in respect of taxable and exempt activities u/r 6(3) of Cenvat Credit Rules
- Reversal required in respect of delayed receipt or non-receipt of export receivables u/r 6(8)
- Reversal required in respect of inter-State stock transfer of VAT paid inputs by partial rebating

In fact, it would merit examining – why a tax payer would have any balance to carry forward? A business that has a reasonable value addition without inversion in tax rates should not have a large amount of credit balance. Surely, there will be some credit balance relatable to inventory but the tax on value addition should ensure utilization of all credits leaving only a small credit balance. But, if a large credit balance is found, it is attributable to:

- High inventory – except for factors like unusually high minimum order quantity or sub-optimal purchase decisions leading to inventory build-up, it is unusual to find business holding lot of inventory as it costs in terms of holding cost and / or potential obsolescence
- Recent investment in capital goods

- Inverted tax structure (current law – viz., local purchase but sold inter-state against declarations or exports)
- Credit availed on doubtful inputs / inputs services and left unutilized (as no interest liability arises in such cases u/r 14 of Cenvat Credit Rules)
- Low value-addition reported

If any of the above reasons are noted, it calls for a thorough inquiry into the real reasons for substantial closing credit balance. And this inquiry will help identify whether the available credit balance requires to be sanitized by adjusting for the above sets of reasons before conceding that whatever balance is available, the same may be carried forward.

Holding inventory entails payment of 'eligible duties and taxes' which is quite a task to recovery u/s 140(3) and whether there are any compelling reasons not to taper off purchases as we near the appointed date to minimize the burden of recovering 'eligible duties and taxes'. Claim for this transition credit states that it is not 'intimation' but 'application'. Application demands disposal by approval. Approval means imminent delay. In view of this eventuality, review the business reasons for holding large inventory on appointed date to identify errors.

Further, if for any reason the balance of credit were carried forward, the 'application' for transition credit resulting in inquiry and if the credit balance is found to be untenable, it would attract interest u/s 50(3) of the CGST Act at a rate not exceeding 24%. Please note that this inquiry may be taken up long after the appointed date which only aggravates the interest burden. One needs to bear in mind that carry over of credit is 'at risk of an interest rate not exceeding 24% on excess credit'. The remedy lies in pre-scrutiny of credit balance – both Cenvat and VAT – for compliance with the likely reasons for high credit balance.

4. Cost Reduction

GST is designed to lower costs (and therefore prices) of supply at each level. It is imperative that the extent of reduction in costs (to suppliers) is examined and such suppliers be put at notice long before the appointed date to pass on the cost reduction. It would be a serious lapse to omit notifying suppliers to bring prices down in respect of current POs where deliveries are likely to be made after the appointed date.

If it is found that supplies are ready to be dispatched, it would be a wonderful opportunity to 'pay VAT / ST' even if the actual supply can be after appointed date (see section 142(11)).

5. Optimizing transition facilities provided in GST

Transition facilities provided in GST are contained in the numerous sub-sections and provisos from sections 140 to 142. It is important to optimize these facilities and some of the steps that can be taken are:

a. Exit beneficial schemes before GST to claim transition credit – pre-GST tax position is found to be a condition for eligibility to claim transition credit. For example, clause (iii) to proviso to section 140(1) states that in certain cases, that the Government may notify, the benefit of transition credit would not be allowed. If there is some advantage that flows in subscribing to a notification under the current law, the same may prove to be counter-productive in respect of input tax credit on inputs in stock on the appointed date which would be liable to GST but not be permitted to transition credit. In such cases, it may be prudent to exit the facility permitted by these notifications near about the appointed date. All though the list of these notifications are not known (yet), but given the restriction involved, all those tax payers availing preferential tax treatment such as '2% excise duty without Cenvat Credit may prepare to exit once the notifications are made known.

b. Non-payment of Reverse Charge dues – for various reasons, demand for service tax on import of services may have been contested even though these services may qualify for Cenvat Credit. Now, this process of litigation may take a long time (certainly long past the appointed date) and although, this tax demand may not come to rest but it is not impossible that among the various uncertainties in tax litigation, there is a more than 'zero' chance of an adverse order. Now, within the domain of this (miniscule) probability of an adverse order, we need to consider that tax, if paid, would be creditable under current law that can easily transition into GST but if this tax were to be paid after appointed date, it would be paid as service tax and would not transition into GST. It therefore merits to consider paying this tax while continuing to contest the demand (up to any forum of appeal) while having included the same in the transition credit. A favourable order will only result in demand for interest and penalty being dropped. An adverse order will entail payment of interest as there would still be a good case for dropping penalty. Though the probability of adverse order is miniscule, ignoring the fact that this matter borders around recklessness to move into GST with RCM notices pending. If the issue involved in a non-creditable tax, then status quo may be continued.

c. Non-payment of Service tax on advances – Advances received are liable to Service tax but tax may not be paid and this is a serious violation which can result in service tax demands being raised after the appointed date too. Payment of GST on these advances or on actual supply

against these advances does not extinguish the service tax default. Double outflow without recourse of transfer the same as credit to customer. It is advisable to review

6. Omissions - Following are illustrative list of areas where errors generally are noted:

a. Cenvat credit not availed on courier bill of entry;

b. Cenvat / VAT credit delayed and not accurately captured in returns filed which must be rectified in the last returns to be filed;

c. Bills towards costs incurred by CHA and claimed as reimbursements are not included in the claim for Cenvat credit, these need to be reworked and captured from up to 15 months ago;

d. Credit reversed due to delay in payment to supplier but the same may have been missed in being restored;

e. Where Cenvat credit may not have been reversed in relation to removal of exempt goods or provision of exempt services, the same may now be carried in the closing balance of Cenvat credit. Care may not have been caused on any interest burden under Rule 14, but this will no longer be true if the credit is transitioned due to the language of section 50(3) of the CGST Act being recast substantially;

f. Credit in respect of goods lying with third parties – demo / trial – may not have been well documented to be claimed now. Now, it is important to identify inputs lying with third parties so as to optimize claim of credit;

g. Eligible refund – VAT, ST and SAD – being allowed to be claimed as refund under the current law even after the appointed date (142(3)), it would be prudent to reverse the qualifying amount of credit in the last returns and make a claim, after appointed date, under the current law. If refund is rejected (partly) on account of failure of nexus test in Service Tax, that would be the last step. And in GST, refund is allowed only in respect of 'tax credit availed during the current tax period' and this appears to exclude 'brought forward balance of credit';

h. Duty free procurement entitlements – Obtained by EOUs – are likely to be ineligible to procure with the full extent of duty exemption after appointed date. Imports being exempt u/n 52/2003-Customs, the same has been modified u/n 44/2016-Customs where the bonded warehouses operated by EOUs have been 'delicensed'. As such any procurement certificates already obtained may be fully utilized to avoid IGST payment on imports;

i. Ensure realization of export proceeds – non-realization of export proceeds attracts requirement to reverse Cenvat credit and if the same is carried forward after appointed date, this aspect will not be masked. Carrying ineligible credit attracts interest u/s 50(3) of the CGST Act. Either reverse the credit in case of unrealized exports or evaluate if the export proceeds may be pursed so as to protect from the risk of credit reversal. Please note that any credit reversed before the appointed date will only be available as refund and not GST credit;

j. Enrolment errors – due to the reluctance to proceed with enrolment / migration, important information about an assessee may not appear in the records of tax administration. Hence, it is important to ensure that information about business activities – taxable and non-taxable – as well as place of business (and not merely the site of discharge of contracted activities) are clearly captured in the records of the administration at the earliest. This extends to identifying depots and branches that are not to continue after appointed date;

k. Several other issues that may merit attention that would be in respect of - amendment to contracts / POs, Rates of taxes / HSN Codes, sales during the current regime and returns / reversal during the GST regime, Goods in transit on the appointed date etc.,

7. Conclusion

While the above discussions are not meant to be an exhaustive list of common errors to attend to, it is meant to guide the various areas of business wherein errors may lie. One may extrapolate based on these areas to identify the approach to eliminating such common errors and transition into GST smoother. This paper has only attempted to stimulate the thought process and does not carry any views on the issues discussed. Reader may also like to view the web cast on common errors on the IDTC web site. However the correctness / appropriateness of the view advanced is to be confirmed with the old law as well as the GST Acts and Rules.

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