

## GST: Impact on the telecommunications sector in India

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### Abstract

The following article is a clear cut explanation of impact of GST on the Telecom Sector. Goods and services Tax (GST) is an indirect tax reforms which aims to remove tax barriers between states and creates a single market. For that to happen, the constitution first needs to be amended to remove different layers of government powers to levy taxes. It is widely expected that the advent of GST is likely to lead to a sudden spike in charges for the ultimate consumers of telecom services that currently attract a tax rate of 15%. One of the biggest impact areas of GST is the compliance requirements that the tax reform brings with it.

The telecom sector, with its mammoth outreach to more than a billion subscribers cutting across state boundaries, is one of the India's core economic drivers. Saddled with high debt pile and need for greater investment, the sector currently faces several issues on the indirect taxation front as well. In view of this, the sector had huge hopes from the proposed tax reforms.

**Keywords:** telecom sector, SIM cards, annual audit compliance, GST

### Introduction

From the conventional belief of being a communication service provider to providing multiple streams of value-added services, the telecommunications (telecom) sector has become one of India's core economic drivers. India is only second to China in terms of the number of connections and subscribers. The sector is also among the top five employment generators in India.

In the present scenario, this sector could be broadly divided into three segments: telecom service providers, infrastructure providers, and equipment manufacturers (Fig-1). Given the mammoth volume of subscriber connections and the revenue generated from this sector, it is evident that the telecom industry is due for a serious overhaul with the evolving indirect tax scenario i.e. the introduction of Goods and Services Tax (GST).

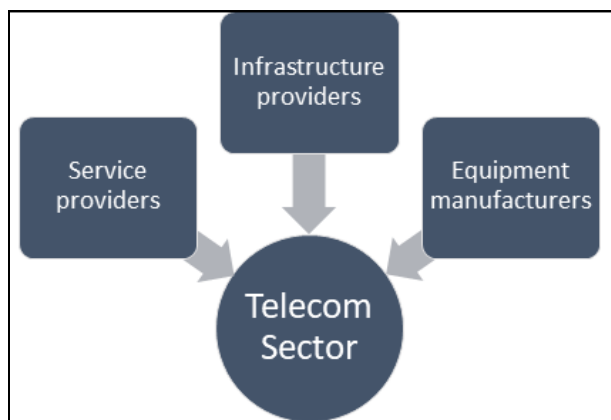


Fig 1: Important areas of telecom sector

GST – possibly one of India's greatest indirect tax reforms - proposes to unify the multitude of indirect taxes in India and

bring all goods and services under a single GST. It will not only boost economic growth but will also improve the ease of doing business in India by allowing a seamless flow of goods and tax credits across all categories of transactions and state borders without any barriers or restrictions.

Presently, the telecom industry faces several shortcomings such as the cascading effect of taxes, issues with the classification of services, etc. that hamper the growth of this sector. In this article, we aim to decipher the various aspects of the telecom sector that may change in the GST regime.

### Selective issues pertaining to the telecom sector under the current indirect tax legislation and evaluation under GST

**1. The concept of 'Necessity Services':** One of the major drawbacks of the GST regime could be the direct spike in the service tax rate from 14% to 20–22%. Being a regressive taxation system, the burn of increased tax rates will directly be faced by the end consumer unless the credit is passed on to the next in business chain.

Given the importance of communication services in our lives, they could easily qualify as 'Necessity Services'. Thus, one could hope that the government considers allotting telecom services under the lower rate category and, in turn, charge a reduced GST rate reserved only for Necessity Goods. Nevertheless, this ambitious demand could be represented but is less likely to be accepted.

**2. Mandatory annual audit compliance:** Until now, telecom service providers did not have to comply with a mandatory 'audit obligation' as per the Finance Act 1994 (as amended). But, they were certainly liable to 'audit scrutiny' by the service tax department if the service provider was identified as the select assessee for audit purposes.

It is widely perceived that under the GST regime, VAT audit procedures may get adopted. With the merger of

both goods and services under one authority, mandatory audit provisions may apply to both goods and service providers alike. As a result, telecom operators may need to engage with at least two entities, one for compliance and another for audit, failing which a possibility of conflict of interest may arise. Such dual engagement with tax firms and management services providers will further lead to an adverse hike in compliance cost.

**3. Status of exemption notification for distributors:**

Telecom companies appoint agents and distributors for sale of SIM cards and recharge coupon vouchers. These agents/distributors are exempted from service tax as per Notification Sr. No. 29(f) of Notification No. 25/2012-ST. But, similar exemptions for distributors may or may not be available under GST. And, if the exemption is rescinded, millions of mobile distributors will have to comply with the provisions of the previously unknown world of indirect tax.

**4. Distribution of input service credits:** Telecom companies usually incur high cumulative service costs such as advertising expenses, legal expenses, etc. that are borne by the Head office (HO) at the first point of contact. The input credit availed for the above is then split across revenue centres through the Input Service Distributor scheme (ISD) under service tax.

But under the GST regime, an ISD Scheme (or any equivalent) is still unheard of, mainly because of the remote practical possibility of splitting a state tax pool (SGST) across other states.

For example, a telecom company HO may incur advertising expenses of INR 1 billion, with input tax credit(ITC) of INR 100 million of Maharashtra GST (MGST @ 10%) and INR 100 million of Central GST (CGST @ (10%)), being local procurement of services. The telecom company then passes on the expenses (not the ITC) to revenue centres across its 22 circles. On the credit front, we can still, theoretically, mull over the possibility of passing on CGST to other revenue centres, but passing on MGST to other revenue centres will not serve any purpose as MGST will not be allowed as ITC in other regions.

As a part of the solution, either the 'ISD Method' could be used wherein modified ISD rules under GST could facilitate credit transfers, or the 'Billing Method' could be used by the HO to simply split the expense and bill the same to the revenue centres for the combined services they acquired at an IGST rate. But as a point of caution, the Billing Method will require strict 'service valuation rules' to ascertain the taxable value on transfer of services; or else, there may be a high possibility that the expense transfers may be misused by corporate to serve as a window for their tax malpractices.

**5. Mobile Wallets:** In these changing times, telecom companies have also evolved tenfold in order to optimize their customer service. From mere communication services, they have grown to include complex services such as value-added services, internet services, advertising services, etc. and next up is the mobile wallet service. Top telecom service providers including Airtel and Vodafone have already launched their mobile wallets,

Airtel Money and Vodafone M-PESA. Most mobile wallets in India follow either the Closed Model or the Semi-closed Model, which restricts the utilization of credit money to a specified set of services.

The indirect tax implication on mobile wallet services remains clouded as several counsels across India have differing opinions regarding its 'point of taxation'. Under the GST regime, it is expected that a clear inclusion of this service within the service ambit or a clear exclusion of this service as a transaction in money should be distinctly defined, thus ending the debate over its taxability.

**Inter-linking charges/charges for access to other circles:** Inter-linking charges are charges paid by telecom companies to one another (telecom peers) for usage of each other's networks and towers when their users are outside their subscribed region. Currently, these charges may get covered under the definition of the term 'services' and hence, service tax is applicable.

Under GST, there are various apprehensions e.g. would GST be applicable in cases where such inter-linking services are provided by one company to another? What would the place of supply of such services be? And in which state would the credit pertaining to the same be available? Furthermore, under GST legislation, it would also be vital to evaluate whether there would be a tax on the supply of inter-linking services between two branches of the same company, considering whether the branches are in the same state or different states.

**6. Cen VAT credit on towers:** Infrastructure providers, also known as tower companies, are one of the three broad segments of the telecom sector. In this regard, it is relevant to refer to Bharti Airtel Ltd vs Commissioner of Central Excise, Pune, wherein credit on the towers, its parts thereof and pre-fabricated building material used for providing telecommunication service, was denied on the grounds that the goods under consideration would neither qualify under the definition of 'capital goods' nor 'inputs' as defined under Cen VAT Credit Rules, 2004. Accordingly, due to the factor of immovability in the goods, there is ambiguity with respect to availing such credit.

Under GST, it would be interesting to understand whether such ambiguity would continue or if there would be some certainty with no restrictions on availing credit. Considering the intention to have a seamless flow of credit under GST, a view can be adopted that there should not be any bar in availing credit.

**7. Place of supply for telecommunication:** Currently, in cases where both the telecom service provider and service receiver are in India, services would accrue at the place of service receiver through Rule 3 of the Place of Provision of Service Rules; but given its central nature, the complications of chargeability were not pondered upon in depth.

However, under GST, it would be pertinent to determine the state that will receive the revenue of the SGST so paid and hence, the telecom companies will require a detailed explanation as to what could be perceived as the Place of Supply of Service. Subscribing to the Destination

Principle, we believe that there are two major possibilities for recognizing place of supply, one being the Place of Service Receiver (permanent registered address) or the Location of Service Receiver (tracked per second by the telecom tower the receiver is utilizing). However, based on feasibility, the former (Place of Service Receiver) could be a likely favorite among lawmakers.

**8. Power and Fuel:** Power and fuel comprise around 5-10% of the total expense in the telecom industry. And unfortunately, at present, indirect tax in the form of electricity duty, excise and state levy on both these expenses cannot be availed as input tax credit. On one hand, petroleum consumption is not considered as an 'input' under the Cen VAT Credit Rules thus, remaining ineligible for credit availment; and on the other, electricity duty also cannot be claimed as a creditable tax as it is a state levy.

The proposed GST law is yet in the law-making phase and can still be influenced by a strong lobby to subsume electricity duty. We have observed globally that countries like Malaysia have subsumed electricity under GST and considered it as a part of either goods or services. Thus, in line with global trends and for the greater good of the industry and trade, we perceive that electricity duty shall be subsumed under GST.

On the other hand, even though petroleum has been brought under the GST regime, unlike others, the central government (with the help of Entry 84 of Union List) and the state government (with the help of Entry 54 of State List) still reserve the right to levy tax on petroleum. Thus, in the worst-case scenario, there is a possibility that petroleum may be liable to all taxes i.e. a GST levy, central levy (excise) and a state levy (VAT), all at the same time. Nevertheless, on an optimistic note, central and state governments may not choose to levy their taxes and under the GST regime, petroleum may finally become creditable once announced by the GST Council.

**9. Sale of SIM cards: sale of goods or provision of service?:** The crux of the various judicial rulings is that the amount received by the cellular telephone company from its subscribers towards SIM cards will form part of the taxable value for levy of service tax as the SIM cards on their own, without the services, would hardly have any value. However, there is a contradiction, wherein certain state VAT legislations (e.g. Andhra Pradesh, Goa, Gujarat, etc.) have specifically included SIM cards in the VAT schedules. So it is not clear whether sale of SIM cards is a sale of goods or provision of service.

#### **Certain common issues foreseen under the GST regime**

- State-wise registration may be required considering the states where services are provided as against centralized service tax registration under the current indirect tax regime.
- Accordingly, compliances (such as documentation, audits, invoicing systems) may be required for each state under which registration has been obtained.
- The entire operating system of companies may need to be revamped to accommodate a state-level, GST-driven mechanism and processes.

- A new GST clause considering the proposed GST may have to be created to replace the existing indirect tax-related clauses under the agreement with various suppliers, customers, etc.
- Considering the probable implications of the proposed GST legislation, companies may consider re-evaluating alternative business structures for undertaking operations.

#### **The registration process under GST**

For obtaining registration, every taxable person shall interact through a common GST portal that is set up by GSTN (Goods and Service Tax Network).

- To apply for registration, the applicant must necessarily have a PAN CARD and will be verified online for the further processing.
- Once it is submitted, a confirmation mail shall be sent through SMS or mail for an authorized signature of the applicant.
- After the signature is verified, acknowledgment under will be generated and once it is approved.
- The GSTIN would send the mail id along with a temporary password.

The telecom sector is undisputedly has a gigantic outreach to more than a billion users, which is actually the core economic drivers. Currently due to high debts, as a large amount of investment is needed to sustain, with the current indirect taxes levied overburdens the sector. The GST has actually raised hopes among the sector as there are various issues due to the indirect taxation. It also gives indefinite powers to the state to levy a tax which becomes difficult to comply with.

Tele companies do not even have any contrivance to track Intra-Circle Termination and roaming supplies. In case, of self-supplies, the valuation needs to be looked closely that it comes to the proposed regime and shall also eradicate the multi-state registrations. Also, the valuation aspects need to be specifically addressed in the case of such self-supplies which seem to come into the tax net in the proposed GST regime and shall have a unified or single state registration instead of multi-state registrations.

#### **Conclusion**

With studies stating that India will emerge as a leading player in the virtual world by having the highest internet users by 2025, there is great untapped potential in the rural market for telecom companies. In order to achieve the congruent goal of broadening the telecom business and attaining socio-economic development, it is essential that the cost of consumption of telecom services goes down, for which it is necessary that lawmakers draft the GST framework considering the issues under the current indirect tax legislation with the intention of curtailing it or having clarity on the same. Additionally, the lawmakers should also consider the advanced products telecom companies offer to their customers (such as mobile wallets) and should seek to cover such transactions appropriately under the new indirect tax legislation with a vision of having minimal litigations at a future date. Furthermore, given the unsettled parliamentary conditions, the industry should step forward and urge the government to clear the GST Bill as soon as possible and help spur overall growth.

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