GST and its impact on online marketplaces in India

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Abstract: *GST or The Goods and Services Tax which is set to roll out from 1st of July, 2017 nationwide in India is being touted as the single biggest indirect tax reform in the Indian taxation system since independence and it's expected to make the tax structure simple with a seamless credit chain. GST is the integrated indirect tax which is levied on the supply of goods and services. There will be dual GST with the Center and State simultaneously levying it on the common tax base. The CGST and SGST will be charged on intra-state supplies whereas IGST(Integrated GST) will be charged on inter-state supplies. The small businesses having turnover up to Rs.20 lakhs are exempted from registering under GST. All the other taxpayer having the turnover of more than Rs.20 lakhs (Rs.10 lakhs in case of northeast states) are required to register and pay GST. The GST is based on the "One tax, one market" concept which should be a welcome step for online marketplaces. In the last decade or so, e-commerce has seen an astronomical growth and India is pegged as the second biggest market for e-commerce after China. The e-commerce market in the country is expected to exceed the $100 billion mark by 2020. The rapid growth in this sector has resulted in conflicts regarding multiple tax issues along with other challenges such as rising competition, dwindling profit margins etc. They are also facing litigation owing to their innovative business models. The Government is trying to make the tax structure simple by introducing GST and promoting trade, while keeping a close watch on tax evasion.*

Key Words: *Online marketplace, e-retail, GST, Central government, State government*

1. INTRODUCTION:

E-commerce is making rapid strides in today's world. In simple words, e-commerce can be described as the carrying out of any commercial activity using the Internet as a medium. The scope of e-commerce is dynamic and ever growing. The online marketplace business model has been the biggest success in India, given the foreign direct investment (FDI) and regulatory norms currently in place. Multiple indirect taxes are currently imposed on transactions in India. Some taxes are charged and collected by the central government, while others are collected by state governments. Moreover, due to the dynamic and complex business models which the e-commerce players use, the way various e-commerce transactions are treated under the prevailing indirect tax regime is full of ambiguities and disputes. Considering the issues plaguing the current indirect tax regime, India is all set to usher in a comprehensive indirect tax regime under the goods and services tax (GST). Since the introduction of the GST regime will affect the very fundamentals of how business is carried out in India, it is essential to take a look at the impact of GST on online marketplaces.

2. WHAT IS GST?

The goods and services tax (GST) is a comprehensive indirect tax on manufacture, sale and consumption of goods and services. It was introduced as **The Constitution (One Hundred and First Amendment) Act 2016**, following the passage of Constitution 101st Amendment Bill. The GST is governed by GST Council and its Chairman is Union Finance Minister of India. Goods and services tax (GST) will subsume various central and state indirect taxes as well as other levies which are currently applicable on inter-state transportation of goods which are also likely to be done away with in GST regime. Let us take a look at the various taxes which will be subsumed by the GST-

Central taxes and levies:

i) Additional customs duty (ACD)
ii) Special additional duty of customs (SAD)
iii) Excise duty
iv) Service tax
v) Central sales tax (CST)
vi) Centre- levied surcharge and cess related to supply of goods and services

State taxes and levies:

i) Value added tax (VAT)
ii) Other state levies such as luxury tax, octroi, entry tax and purchase tax

iii) State-levied surcharge and cess related to the supply of goods and services
iv) Taxes on lottery, betting and gambling

There are certain taxes which have been kept outside the purview of the GST. They are mentioned below-
i) Basic customs duty (BCD)
ii) Stamp duty
iii) Taxes and duties on electricity
iv) State excise duty
v) Taxes and duties on alcohol for human consumption and amusement/ entertainment/ petroleum products until recommended otherwise by the GST council.

The GST council in its meeting in November, 2016 had agreed to a four rate structure under GST of 5, 12, 18 and 28 percent. While most services will be taxed at a higher rate of 18 per cent as against the current rate of 15 per cent, exceptions such as road transport are likely to continue which will be taxed at the existing rate that includes abatement. Some including education, health care and even pilgrimage related services will continue to enjoy exemptions. Experts also noted that the government has retained the power to levy cess on additional items under GST.

3. WHAT IS AN ONLINE MARKETPLACE?

An online marketplace (or online e-commerce marketplace) is a type of e-commerce site where product or service informations are provided by multiple third parties, whereas transactions are processed by the marketplace operator. Online marketplaces are the primary type of multichannel ecommerce and can be described as a "simple and convenient portal" to streamline the production process. In an online marketplace, consumer transactions are processed by the marketplace operator and then delivered and fulfilled by the participating retailers or wholesalers (often called drop shipping). Other capabilities might include auctioning (forward or reverse), catalogs, ordering, wanted advertisement, trading exchange functionality and capabilities like RFQ, RFI or RFP. These type of sites allow users to register and sell single items to a large number of items for a "post-selling" fee. In general, because marketplaces aggregate products from a wide array of providers, selection is usually more wide, and availability is higher than in vendor-specific online retail stores. Also prices may be more competitive. In the last few years online marketplaces have thrived in India. Some have a wide variety of general interest products that cater to almost all the needs of the consumers, however, some are consumer specific and cater to a particular segment only. Not only is the platform for selling online, but the user interface and user experience matters. People tend to log on to online marketplaces that are organized and products are much more accessible to them.

Some of the prominent marketplaces in India are Flipkart, Amazon, Snapdeal, Paytm, HomeShop18, Shopclues, Myntra and Jabong. While **Morgan-Stanley** estimates the market size up to $120 billion in 2020, the **UBS Group** puts this number to $48-60 billion.

4. CHALLENGES ONLINE MARKETPLACES ARE GRAPPLING WITH UNDER PRESENT TAX DISPENSATION:

i) There is considerable amount of grey area regarding payments of VAT, CST and entry tax. The local tax authorities sometimes misconstrue the activities of online marketplaces as being carried out by sellers. Even though the involvement of online marketplaces in the transaction process is limited to only facilitation and sometimes holding the inventories in their fulfillment centres and forwarding the consignments to the buyers by packing or repacking, the authorities insist that they are dealers and hence liable to pay taxes and meet all the other norms.

ii) Under normal circumstances, a dealer in a state has the responsibility to obtain waybills from VAT authorities either manually or through online process. Even though the online marketplaces are not dealers, since there are a number of interstate movements (procurement from vendors, supply to customers), the compliance requirements need to be minutely tracked and movements need to be facilitated with proper documentation. E-tail transactions are generally of low value. Hence, it is not practically feasible to carry out elaborate compliance processes for each consignment of low-value items.

iii) Entry tax is imposed on the physical entry of goods into a defined 'local area' within a particular state. The entry tax rules of various states define the 'importer' or 'dealer' as responsible to get registered under entry tax laws and pay the applicable tax. In view of the definition of 'dealer' under different state entry tax rules, it is possible that an online marketplace and its associated fulfillment centres in a state might qualify as an 'importer' in some states. In such cases, online marketplaces are expected to obtain registration, deposit tax and carry out all related compliance. At present, there is ambiguity regarding the entry tax treatment of these transactions in various states.

iv) A number of states have recently started making provisions for furnishing of information by e-commerce players. There are no provisions under most VAT legislations that correctly define online transactions. VAT authorities have started to demand a vast amount of information under the assumption that this information will help tax evasion. The fluctuations regarding statutory obligations in each state lead to a high compliance cost and waste of valuable time for online marketplaces.

v) VAT/CST is required to be paid on the sale of goods. The sale price on which such VAT/ CST is payable is defined under different VAT legislation. Generally, sale price means the amount of valuable consideration paid or payable to a dealer for carrying out any sale, including any amount charged for anything done by the seller in respect of the goods prior to delivery (transportation, installation, etc.). Practically, the cost of the huge discounts offered by vendors on e-commerce sites is borne by the e-commerce players. VAT authorities are nowadays demanding tax on the offered discount by treating the amount being paid by the e-commerce players as part of the sale price for goods on behalf of the customers. Hence, the authorities intend to tax the loss incurred on trading of goods.

vi) Generally, there are specific provisions under state VAT regulations for adjustments to be made in taxable turnover on account of sales returns, cancellations, etc. E-commerce players frequently offer products on cash on delivery (COD) mode of payment to customers. According to the COD rules, a customer has to make payment only when the goods are physically in his/her hand and he/she is satisfied with the delivered product. This results in a number of cases when sale of goods does not eventually take place because the customer is either not satisfied with the product and refuses to pay or is not reachable at the address provided. Further, since there is a time lag between order placing and product delivery, some customers might cancel the order before delivery. Given the above situation, the amount of sales returns and order cancellations in the e-commerce industry is pretty high. There are also returns of small sized products and cancellations rather than bulk ones, as in the case of traditional sellers. In these situations, it is difficult to maintain records intact for each case in each state as well as to properly claim adjustment for such returns from the VAT authorities. Even when such returns are properly adjusted, substantiating the amount of deduction claimed as sales returns at the time of VAT assessments becomes cumbersome.

vii) Sale of goods attracts VAT/CST and ‘goods’, as defined under various VAT legislations, include tangibles as well as intangible items. Some states have specific entries for taxing intangibles. While the taxing of intangibles that are supplied over a medium is relatively easier, there are no specific provisions for the download of digital contents online. Digital contents such as softwares, e-books and music albums is often sold over the Internet. Generally, once this content is purchased from the portal, it can be accessed by the customer from any device by simply downloading after entering the login credentials. This mode of delivery is peculiar to the e-commerce industry. While there are no clear laws in this regard, given that such digital content is capable of being bought and sold, transmitted and delivered, and has inherent utility, such content may be deemed to be goods liable to VAT/CST. Further, if a position that VAT/CST is payable is adopted, then there will be legitimate concerns regarding who is liable to pay VAT/CST, the appropriate state (location of seller vs location of server vs location of buyer) and compliance to be undertaken.

viii) VAT/CST is payable at the prevailing rate applicable on the sale of goods. The applicable rate is based on the exact nature and description of the goods sold. Further, composite supplies of both goods and services may qualify as ‘works contracts’ which results in specific tax treatment under indirect taxes. Similar to traditional retail sales, a bundle of two or more related goods (or goods plus services) is offered as a combo offer for a single consideration by sellers over online marketplaces. In case the goods bundled together under the combo offer attract VAT/CST at different rates, the authorities may impose tax at the higher rate, resulting in an increase in the overall cost of the product. In the absence of any reasonable basis of bifurcation of the consideration, in many cases, tax is being paid at the highest applicable rate to avoid litigation, leading to an increased cost. Further, if goods and services are being combined under these combo offers, such offers should be clearly analysed to ascertain whether they qualify as works contracts.

ix) CST is payable on the interstate movement of goods. While CST is a central tax, it is administered by the state VAT authorities. Thus, CST has to be deposited with the VAT authorities of the concerned state, as determined under the Central Sales Tax Act, 1956. The concerned state is generally the state where the movement of goods commences. Given that online marketplaces cater to the entire country (as well as overseas), movement of goods happens all around India. Further, unlike conventional businesses, the number of unique transactions is also high. Given this fact, it is difficult to pinpoint the ‘appropriate state’ to discharge VAT/CST as every single transaction needs to be carefully analysed. In cases where goods are moved from one state to another before finally being dispatched to the customer, it is essential to have clarity on which tax is chargeable on the transaction and in which state.

x) Input VAT is creditable against output VAT/CST subject to the prescribed conditions and procedural requirements in each state. Given the complex transaction structures, credit blockage at each stage of the transaction translates into higher cost for the online marketplaces as well as increased cost for the final consumer.

xi) Service tax is levied on an activity for a consideration (unless specifically exempted or excluded). Further, service tax is payable on services relating to access of online information, database access and retrieval services, as well as the development and supply of digital content and software. In the case of digital content, the definitions of 'goods' and 'services' overlap. Practically, online marketplaces end up paying both VAT/CST as well as service tax on transactions in digital content, leading to double taxation. The taxability of transactions in digital content is subject to extensive dispute and litigation. Whether the content is standardised or customised, service tax vis-à-vis VAT and location of transfer of content are leading to dual taxation of such transactions.

xii) Service tax paid on input services is only eligible against output service tax (or excise duty for a manufacturer), subject to the fulfillment of conditions prescribed under the Central Value Added Tax (CENVAT) Credit Rules, 2004. Given the complex transaction structures, credit blockage at each stage of the transaction results in higher cost for the e-commerce player as well as for the final consumer.

xiii) Excise duty is payable on the manufacture of goods in India. Under excise legislation, the definition of the term 'manufacture' includes a number of activities. Further, activities such as packing, repacking and labeling with respect to certain goods have been 'deemed' to be manufacture under excise legislation. Thus, any entity undertaking an activity that amounts to manufacture is liable to pay excise duty at the applicable rate on any such activity and to undertake all related compliance in this regard. Excise duty in the case of manufacture of certain goods covered by the Legal Metrology Act, 2009, is based on the maximum retail price (MRP). The activities undertaken need to be analysed in light of the definition of manufacture under excise legislation. If such activities qualify as manufacture, then online marketplaces will be required to obtain excise registration and undertake related compliance. The onus of compliance with the Legal Metrology Act is on the vendors in the case of marketplace and warehousing models. However, online marketplaces are still expected to extend full cooperation to the authorities under the Legal Metrology Act and to exercise due diligence from this perspective, if required. Thus, even if no excise duty is payable, it adds to the compliance burden of e-commerce players.

5. CHANGES IN TAXATION SYSTEM REGARDING ONLINE MARKETPLACES POST GST IMPLEMENTATION:

i) Under the present tax structure, different states impose different VAT rates on the same goods. Online marketplaces register sellers who need to charge lower taxes thus making the product cheaper than local retail prices. The e-tailers often enter into exclusive tie-ups to derive advantages from tax arbitrage. Post GST, there will be standard tax rates for each product and tax arbitrage will not be possible, thus bringing e-tailers and offline sellers at par in terms of costing and pricing.

ii) Under GST, online marketplaces will have to deduct 1% tax while making payments to sellers registered on their portal. This Tax Collected at Source (TCS) will be handed over as collection towards GST to the government. This rule however is not applicable to offline retailers. With TCS, capital will be locked away for periods between 20-50 days depending on the transaction date. The significant impact on the cash flow will force smaller firms to seek additional working capital or ignore the e-commerce marketplace altogether, as it may not offer any convenience and benefits.

iii) While GST registration in normal circumstances is mandatory where turnover is Rs. 20 lakh or more, if a trader wishes to sell through online portals he needs to get registered irrespective of turnover. Merchants without proper registration will be forced to move out of the online system. Now, all sellers will be required to be registered and charge taxes at prevailing standard rates, creating a level playing field for all online sellers in terms of product pricing.

iv) Majority of the products sold online carry a return date of up to 30 days which translates into about 15 - 20 million transactions per month and the returns and refunds for these have to be done with utmost care. The returns are required to be filed monthly now by both parties and refund adjustment will need special attention impacting tax liability.

v) The output rate of tax could be higher for the company compared to the current service tax rate. However, the companies should have a higher credit pool than they do in the current regime, which could reduce the prices of their services.

vi) Currently, e-commerce companies discharge their output service tax liability through centralised registration. But under GST, e-commerce companies would have to obtain registration in each state where they have their place of business, resulting in increased compliances.

6. CONTROVERSY INVOLVING THE 1% TAX COLLECTION AT SOURCE (TCS) IMPOSED ON ONLINE MARKETPLACE TRANSACTIONS:

E-commerce companies will have to mandatorily deduct up to 1 per cent TCS (Tax Collected at Source) while making payments to their suppliers under the GST regime. The model Goods and Services Tax (GST) law, finalized by the GST Council, makes a provision for 1 per cent TCS to be deducted by the e-commerce operators. The model law states that every electronic commerce operator, not being an agent, shall collect up to one per cent TCS, as may be notified on the recommendations of the Council, of the value of taxable supplies made through it by other suppliers where the consideration with respect to such supplies is to be collected by the operator. Experts had raised concerns saying this would mean that a similar amount will have to be levied on inter-state movement of goods, taking the total TCS deduction to 2 per cent. Industry has been expressing concern over the TCS provisions saying it would mean a lock-in of capital which will dissuade companies from selling through online aggregators. E-commerce companies will also have to file returns on the TCS deductions, but in case of return of goods by the consumer, these companies will not have to deduct TCS as there is no actual sale.

7. CONCLUSION:

Rollout of GST will definitely usher in a new era in the Indian taxation system. The dream of “one market-one tax” will finally become a reality. Even though the GST in the present form is not perfect by any stretch of imagination, the apparent benefit the industries are going to derive out of its implementation is immense. Under GST law, it is acknowledged that merchants can make supplies from warehouses owned by e-commerce operators. The provision states that government officials of the rank of Joint Commissioner or above can demand information about the stock of goods held by e-commerce operators on behalf of merchants. Ideally, we should see tax issues arising out of e-commerce companies fulfilling orders to disappear. The headache associated with inter-state transport of goods will be a thing of the past. Today, e-commerce companies in India are mired in a plethora of taxes, including VAT, CST, Excise, Service Tax, and TDS, with multiple taxes applicable on any given transaction. The implementation of GST will make the taxation system simple by subsuming all of them. Hence, for online marketplaces which under the present taxation regime is pretty vaguely defined, will get a much needed boost.

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