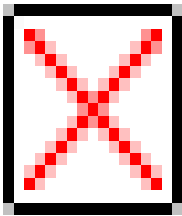


## Is India's GST Law geared to support the Fintech revolution in the post-Covid market? - Part II

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*(This is the 2<sup>nd</sup> of the 3 part discussion paper wherein the author brings out the importance of fintech in the modern world and how India's GST law tries to enable this digital revolution)*



**Fintechs in India face unique GST challenges**

IN

the introductory part, we understood what fintech is all about and delved deep into the world of electronic payments and the GST implications for Fintechs in the e-payment ecosystem. However, e-payments is only a small section of the universe in which fintechs operate. Infact, today, there are many more dimensions of financial services that are eponymous with fintech. A few of these are discussed below in some detail before we understand how GST is impacting the operations of fintechs in these areas.

### **Asset Management**

Some fintech companies are enabling investors to trade for free in exchange for their data. They forward this data to high frequency traders who can then influence the price of the asset. Even though the investor might pay a slightly higher price for their asset, the difference between the amount they save from trading fees and the slight increase in price is still positive.

From a GST stand point, 2 issues are required to be categorically addressed. Firstly, what is the service provided by the fintech company to the investor? And secondly, if it is indeed a supply, what is the consideration received by the fintech from the investor, for such service, if there is no underlying agreement between the company and the investor that the fintech company is going to share the investor's trading data with the high frequency traders in return for free trading on their platform.

Let us start with the first question. What is the service that the fintech is offering the investor. It doesn't really own the trading platform. It merely enables the investor to use it. Will such entitlement to use the platform qualify as a service?

Let us look at what is specifically a service under the IInd Schedule to the CGST [Act, 2017](#). Clause 4 of the said schedule specifies, **"development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software"** as a service.

Does the Fintech company provide any of the above to the investor? The answer is negative.

Interestingly, clause 5 of the said schedule also mentions,

**"agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act; and Clause 6 specifies transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration"**, to be a service.

Does the activity of allowing the investor to trade on the platform imply tolerating an act or can the trading platform be construed as goods to imply transfer of right to use it. Again, the answer to these questions is in the negative. Therefore, it is difficult to foresee how it will be construed that the fintech company is indeed undertaking a supply of a service to the investor, in order to attract GST.

Now, presuming that there is somehow a clear answer to the above question in so far as permitting the investor to trade on the platform is indeed a supply of service, let us seek the answer to the next question, which is **"what will be the value of such service?"** .

Rule 27 of the CGST [Rules, 2017](#) states that,

**"Where the supply of goods or services is for a consideration not wholly in money, the value of the supply shall,-**

**(a) be the open market value of such supply; (b) if the open market value is not available under clause (a), be the sum total of consideration in money and any such further amount in money as is equivalent to the consideration not in money, if such amount is known at the time of supply;**

**(c) if the value of supply is not determinable under clause (a) or clause (b), be the value of supply of goods or services or both of like kind and quality;**

**(d) if the value is not determinable under clause (a) or clause (b) or clause (c), be the sum total of consideration in money and such further amount in money that is equivalent to consideration not in money as determined by the application of rule 30 or rule 31 in that order."**

It is obvious that value will not be possible to determine by applying clauses (a), (b) or (c) as there isn't any market comparable value nor any money equivalent. Hence one is required to take recourse to Rule 30 or Rule 31 of the CGST Rules, 2017.

**"Rule 30. Value of supply of goods or services or both based on cost**

**Where the value of a supply of goods or services or both is not determinable by any of the preceding rules of this Chapter, the value shall be one hundred and ten percent of the cost of production or manufacture or the cost of acquisition of such goods or the cost of provision of such services.**

**Rule 31. Residual method for determination of value of supply of goods or services or both**

**Where the value of supply of goods or services or both cannot be determined under rules 27 to 30, the same shall be determined using reasonable means consistent with the principles and the general provisions of section 15 and the provisions of this Chapter:**

**Provided that in the case of supply of services, the supplier may opt for this rule, ignoring rule 30."**

Given that there is no cost of acquisition to the fintech for making the platform available to each investor, Rule 30 (*supra*) could be discarded. Finally, comes Rule 31. It would be quite interesting to find out what could be the 'reasonable means' adopted to arrive at the value that is required to be determined under this Rule.

In other words, this is where a potential dispute with the GST authorities can set in for the Fintech.

## **Digital insurance**

Fintech companies operating in the insurance industry (also known as 'Insurtechs') are taking all of the traditional services to the digital world. Offering life and health insurance with better underwriting practices, these FinTechs can price their premiums at variable rates depending on the customer, thereby offering aggressively cheaper coverage compared to traditional insurance companies. These types of insurance, together with personalized marketing, create business possibilities. Being completely on cloud gives these companies the flexibility to scale up faster and offer customised APIs for other partners in the digital ecosystem. Bundled products can be sold digitally in an easy manner as compared to traditional channels as digital brings convenience as well as market penetration, that has been long dominated by traditional insurers.

## ***The Regulatory Sandbox***

Insurance Premium and other fees and charges that are typical revenue streams for any traditional insurance company also holds true for an insurtech's business revenues. However, very often, these fintechs could be booking certain revenues that may flow in from channels where revenue cannot be reliably measured such as the policies in the regulatory sandbox. It is these revenues that the authorities may go after, given the all-encompassing nature of the expression 'supply' under the GST law.

The Insurance Regulatory & Development Authority of India (IRDAI) approved rules in 2019 to allow a conducive environment for fintech companies to carry innovation in the insurance space. <sup>1</sup>

Pursuant to these regulations, IRDAI has encouraged insurtechs to put new products in a test market before it approves the same. This is the concept of the regulatory sand box. Applicants (Insurtechs) are permitted to introduce products in a test market with the regulator having set a cap of 10,000 policies and Rs 50 lakh premium for experiments in the sandbox environment. <sup>2</sup>

Two questions can arise in the case of these sandbox policies -

One, whether the insurtech is required to charge GST on the premium charged on such sandbox policy; and

Two, what will be the fate of the GST charged on the premium amount if IRDAI doesn't approve the scheme?

Given the fact that not much has been forthcoming in the form of a clarification from the Central Board of Indirect Taxes & Customs (CBIC) on such issues, one is forced to take recourse to the guidance provided by the recent Advance Rulings issued, even though these rulings aren't binding on any person other than the applicant and the respondent named therein.

In the instant case, it is pertinent to first understand what would be the accounting treatment of the premium received by the insurtech from the proposer. Whether, it would book the receipt as an advance or as a deposit until the IRDAI approves the scheme.

In this connection, in a recent ruling <sup>3</sup>

by the West Bengal Appellate Authority for Advance Ruling, a distinction was sought to be made on the tax treatment under GST law to sum of money received. It was observed by the appellate authority that

***"there are certain distinguishable features of both advance and deposit - For instance, an advance does not earn any return on it whereas a deposit earns interest - An advance has to be utilised for the specific purpose for which the advance is made whereas utilization of a deposit depends entirely on the person with whom it is deposited"***

Thus, if the insurtech has accounted for the receipt as an advance, it may be prudent on the part of the insurtech to charge GST on the policy issued and subsequently, if the IRDAI declines to approve the policy, the insurtech is required to issue a credit note to the proposer of the policy. <sup>4</sup>

This is because the time of supply of the service for advance received is determined as per the provisions of Section 13(2) of the GST Act. <sup>5</sup>

## **Trade Finance**

The extreme digitisation of trade in the post-covid era and the increasing connectivity to trade platforms give financing providers better visibility of clients' trade performance and business patterns. For example, by being part of the Government of India backed TReDS initiative <sup>6</sup>, small and medium sized businesses (MSMEs) gain the opportunity to digitise their trade process and achieve better visibility, plus they simultaneously connect, access, and interact with banks more efficiently, thereby enabling 'organisational agility.'

Any digital platform approved by the Reserve Bank of India (RBI) under the TReDS initiative facilitates the discounting of both invoices as well as bills of exchange. The three direct participants in the system are the MSMEs (sellers), Corporate Entities (buyers) and the Financiers (NBFCs, banks and factoring companies). The digital platform provides a level-playing field where all the participants work together for facilitating, accepting, discounting, and settling invoices.

### ***How does the GST law help the Fintech Companies in Trade Finance?***

Readers may recall that in its 35th meeting, the GST Council resolved to adopt the system of electronic invoicing or e-invoicing made applicable to specified categories of persons. E-invoicing is the submission of an already generated standard invoice on a common portal. It automates multi-purpose reporting with a one-time input of invoice details. This not only ensures transparency in the B2B trade for organizations generating these e-invoices from their enterprise resource planning (ERP) systems, these invoices are also critical to providers of trade finance, which must analyze the bills in order to underwrite a loan. Thus, e-invoices will help in addressing fraud - one of the largest

pain points in supply chain financing today.

The GST Council, in its 39th meeting held in March 2020 announced the deferment of e-invoicing until 1 st October, 2020, in the wake of the widespread slowdown in business activity due to the Covid-19 pandemic.

## Summing up

As frictionless systems like distributed ledgers eliminate barriers and unlock greater economic activity to promote prosperity, businesses need to use these software applications to transfer value to consumers with efficacy<sup>1</sup> and bypass unnecessary red tape created by the domestic tax laws.

Fintech entrepreneurs are seeking the elimination of barriers to high speed and super efficient way of undertaking financial transactions that will result in greater economic activity and new wealth. On the other hand, tech-savvy consumers in the Indian market are also looking upto innovations like blockchain, tokenization<sup>2</sup> and peer-to-peer networks from the fintechs. These are disruptive technologies that are forcing a large, entrenched ecosystem to adapt. However, these could in turn unleash a very complex web of supplies and considerations that may not only become a challenge for GST authorities but their very complex nature could also create immense impediments for these fintechs in the simplistic interpretation and implementation of the provisions of GST law.

In our third and concluding part, we take a look at the GST challenges for fintechs that help financial institutions ensure compliance with the burgeoning volume of new regulations. These are also known as Regulatory Technology (RegTech) companies.

â€¦ to be continued

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See [Part I](#)

<sup>1</sup>IRDAI Press Release bearing Ref. No . IRDAI /INT/ Reg Sandbox/ 08/ 2019 dated 22 nd August, 2019

<sup>2</sup>Source: The Economic Times

<sup>3</sup> Siemens Ltd.; [2019-TIOL-78-AAAR-GST](#)

<sup>4</sup>Section 34(1) of the CGST [Act, 2017](#) provides that,

***"where one or more tax invoices have been issued for supply of any goods or services or both and the taxable value or tax charged in that tax invoice is found to exceed the taxable value or tax payable in respect of such supply, or where the goods supplied are returned by the recipient, or where goods or services or both supplied are found to be deficient, the registered person, who has supplied such goods or services or both, may issue to the recipient a credit note containing such particulars as may be prescribed."***

<sup>5</sup> Re: Siemens Ltd. (*supra*)

<sup>6</sup> The scheme for setting up and operating the institutional mechanism for facilitating the financing of trade receivables of MSMEs from corporate and other buyers, including Government Departments and Public Sector Undertakings (PSUs), through multiple financiers is known as Trade Receivables Discounting System (TReDS).

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