The Impact of Goods and Services Tax (GST) Implementation on the Indian Banking Sector: A Comprehensive Analysis

Nirupama Subramanian[1]
[1]*Student, B.Com. (Management & Finance), SVKM's Narsee Monjee College of Commerce and Economics, University Mumbai, Maharashtra, India*

***Abstract*—This study examines the effect of Goods and Services Tax (GST) on the Indian banking sector including the challenges and opportunities arising due to its implementation. This research serves the study shift in operational dynamics of the banking sector forced by GST, to bring into perspective an analysis based on tax compliance, customer experience, and the changes brought in regulatory aspects. Findings show simplified tax structures; enhanced transparency; and input tax credits to be an important benefit. The drawbacks include the complexities of operations, state-wise registrations, increase in compliance costs, and banking service's tax rates. Some insights are presented in connection with a landmark case "Commissioner of GST and Central Excise vs. M/s Citibank N.A." which illustrate the practical issues confronting the sector in light of GST provisions. Findings also indicate that GST could only reduce the cascading effect of taxes, particularly in interbank dealings, but have brought higher complexity in inter-branch transactions and increased the cost of banking services. The original contributions of the study on GST have arisen from the realities and implications that GST would present toward the endeavour at repositioning the banking sector. The findings hold relevance for the policymaking community, banks and financial institutions, as well as the various regulatory bodies in providing most pertinent insights into the changing economic landscape of taxation.**

***Index Terms*—GST, Taxation, Banking Sector, India, GST Implementation, Tax System.**

I. INTRODUCTION

The Goods and Services Tax was introduced on July 1, 2017, in India, marking a giant leap towards the economic reform. It replaced many taxes such as VAT, service tax, and excise duties with the intention of unifying India's complex tax structure into a single, transparent system. Theoretically, GST was meant to make the tax system more efficient, reduce tax on tax, and spur economic growth by enhancing the ease of doing business.

Before the advent of the GST regime, the banks operated under the Service Tax Act, in which 15% tax was imposed on various banking services. The subsequent implementation of GST raised this tax rate to 18%, creating many challenges for the banking industry in India. The other key change brought about by GST was the compliance burden placed on Indian banks in terms of registration rules and services taxes. As the banking sector contributes about 7.7% to the Indian GDP, the ramifications of this will be far-reaching in the broader economy.

The transition to GST has put together the many opportunities as well as challenges. The uniformity of the tax will eliminate the cascading effect of taxes, provide transparency, and enable smoother bill transactions between states. The challenges posed to banks are ushered in by GST which increases the operation cost because of the higher compliance requirement and the need for registration in various states. The other challenges that have emerged are in the understanding of what GST applies to and whether the financial products fall under taxation.

This paper addresses and analyses the impact of GST on the Indian banking sector with the support of various sources of literature, government reports, case studies, and academic research.

II. LITERATURE REVIEW

Several studies have been conducted to assess the impact of GST on the banking sector in India.

Revathi R., Madhushree L. M., and P. S. Aithal (2018) discussed the elements of transparency, compliance burden, and overall working environment showing the operational environment of banks. Their research indicates that there are simplified taxation benefits for the banking sector, but the high rate of taxes with heavy documentation has caused issues in the operational processes.

As a result of the introduction of GST into the Indian banking sector, both challenges and opportunities were presented. When researched by Meena, increased compliance related to GST has been more complex; Kaur etal. mention its advantages include transparency about double taxation. However, Kumar and Rafee see inflationary effects into banking services. Public sector banks are also overstretched and face shortage of staff in order to meet branch level compliance for registration (Shetty et al., 2022). Notwithstanding this, GST improved the quality of banking services and put in place a much more uniform tax structure. They also mention the concerns faced by the public sector banks which due to limited number of human resources and infrastructure find it difficult to comply with the complex requirements of GST. The research points out the rising pressure of inflation on banking services, more so after the changes that increased the tax rate of banking services from 15% to 18%.

In connection with their research, “Indian Banking Sector - Issues and Challenges on GST in Nagercoil Town” P. Javin Prija and Dr. P. Asha study the effect of goods and services tax on Indian banking. Major challenges they observe include state-wise registration of bank branches, increased compliance costs, taxation on transactions between bank branches under IGST, and changes in service tax rates from 15% to 18% which make banking services such as loans, investments, and ATM transactions costlier for consumers. However burdensome, GST has brought forth a line of uniformity, aided government revenue, and is nonetheless a highly taxing exercise for both banks and customers alike.

Another important aspect addressed in the papers on the impact of GST on banking pertains to the lack of clear legal guidelines surrounding complex financial transactions in Geo-Special multi-party arrangements. The ambiguity in GST laws with regard to the taxation of interchange fees is best illustrated by the case study of Commissioner of GST and Central Excise vs. M/s Citibank N.A.

Comparative insights from global literature on the impact of GST in other countries like the EU, Australia, and Canada show varying levels of success in implementing GST in those counties. Studying their experiences could provide valuable lessons for India. These studies suggest that while GST is more tax-efficient, it must be applied with enough care to limit operational burdens, especially for complex sectors such as banking.

III. METHODOLOGY

This study adopts a qualitative approach, utilizing secondary data from government publications, legal case studies, academic papers, and industry reports. The methodology includes a comprehensive analysis of the challenges and opportunities presented by GST in the banking sector. A case study approach is used to illustrate how GST has impacted the banking sector in practice, with a particular focus on the legal case *Commissioner of GST and Central Excise vs. M/s Citibank N.A.*

It involves the following:

- Official reports and notices of the government relating to the introduction of GST.
- Case studies and judgments regarding GST in context to the banking sector.
- Academic research paper analyses of the impact of GST on the banking industry.

IV. ANALYSIS/DISCUSSION

This study highlights the GST implementation impacts, the advantages as well as the disadvantages of the implementation of GST on the banking industry along with a case study.

A. Effects of GST Implementation on the Banking Sector

- Registration of all the Branches – Under the previous tax regime, banks had a centralised registration, even with pan-India operations. However, under the new tax regime, banks had to register themselves separately for branches in every state (Section 22 of CGST Act).

- Filing for Returns – The burden of compliance for filing returns increased substantially due to the periodicity of returns, number of return formats and level of details required in these returns.
- Determining Place of Supply - As per section 12(2) of the IGST Act, 2017, in case of banking and other financial services, the place of supply shall be the "location of the recipient of service" on the records of supplier of services, this has created challenges in determining tax liabilities, especially for pan-India operations.
- Invoice Requirements - As per rule 47 of the CGST Rules, 2017, the banking companies are required to issue tax invoices to the customers within 45 days from the date of supply of Banking services instead of 30 days.
- Inter-Branch GST Implications – Under GST, banks are subject to taxes for interstate transactions between two branches of the same bank.
- Input Tax Credit (ITC) - Under GST, a banking company or a financial institution engaged in the supply of services through acceptance of deposits, granting loans or giving advances were allowed to claim ITC under Section 17(4) of CGST Act, 2017.

B. Advantages of GST Implementation on the Banking Sector

- Reduction of Cascading effect – GST has replaced multiple indirect taxes, thus overlapping of taxes in different sectors of the products from production to consumption has reduced.
- Uniform Tax Rate - In the banking sector, GST maintains a uniform tax rate of 18% i.e., all the services are taxed for 18%.
- Compulsory Registration - Under GST, there is compulsory registration for the banks in each branch they operate, thus reducing the confusion in the tax mechanism in each state and each branch for any transaction.
- No Tax on Deposits - The banks are not charged any GST on deposits made by the customers. It is totally exempted from GST, thus increasing the deposits of the bank.
- Input Tax Credit (ITC) - Bank will be able to fully set off their GST liabilities against credit received on purchase of goods.

C. Disadvantages of GST Implementation on the Banking Sector

- Higher Service Tax Rate – The tax rate was increased from 15% to 18% for all banking transactions, thus making them costlier for the customers.
- Complex Compliances – The state-wise registration and multiple return filings under GST have increased the burden on the banking industry.
- Inter-Bank Transactions – Each transaction between two branches of the same bank attracts IGST, making it more expensive and inconvenient for the banks.
- Home Loans – Earlier home loans only had a tax rate of 8.5%, but under GST, they also attract 18%, which is a huge increase of 9.5% on home loans.

V. COMPARISON OF TAXATION POLICIES PRE AND POST GST IN THE BANKING SECTOR

Particulars	Old Tax Regime	New Tax Regime
Service Tax Rate	15%	18%
Service taxes in Interest income	No	Yes
Taxes on Services by RBI	No	Yes
ITC for Banks	Disallowed	Allowed
Centralised Registration	Yes	No
Return Filings	Annually	Monthly/Quarterly + Annually
Power to levy tax	Central Government	Central Government and State Government

Taxes on Fund based activities	No	Yes

VI. CASE STUDY - COMMISSIONER OF GST AND CENTRAL EXCISE VS. M/S CITIBANK N.A.

This case revolves around the taxability of interchange fees received by the Citibank for processing credit card transactions.

A. Overview of the Case

The whole case is centred around the "*interchange fee*" that Citibank received from other banks for processing credit card transactions, and whether Citibank is liable to pay service tax on the interchange fee received by it.

A Division Bench of the Hon'ble Supreme Court (SC) comprising of Justice K.M. Joseph and Justice S. Ravindra Bhat, concluded that the interchange fee is a taxable service covered by the taxing entry for credit card services and under the negative list.

B. Arguments by the Parties

- Citibank (Respondent): Argued that it did not provide any service for which interchange fees could be taxed independently. It claimed that taxing interchange fees separately would lead to double taxation, as acquiring banks already paid service tax on the gross amount received from merchants.
- Revenue Department (Appellant): Contended that interchange fees represent a distinct service provided by issuing banks to acquiring banks. Hence, Citibank was liable to pay service tax under the widened definition of credit card services.
- Observations by the Supreme Court
- Justice K.M. Joseph: Asserted that interchange fees represent a consideration for services provided by the issuing banks. He emphasized that the issuing bank's role in the credit card ecosystem, including assuming financial risks, qualifies as a taxable service. However, he acknowledged the risk of double taxation and remanded the case to the Tribunal to determine if service tax had already been paid by acquiring banks.
- Justice S. Ravindra Bhat: Disagreed, holding that the interchange fee was subsumed within the broader service provided by acquiring banks to merchants. He argued that taxing it separately would indeed result in double taxation and that Citibank's services were an integral part of a single unified service.

C. Implications on the Banking Sector

The consequences of the case primarily revolve around the complexities of multi-party financial transactions under GST:

- It draws attention to the necessity of a more precise GST structure: The ambiguity in the GST legislation regarding multi-party transactions is evident in this case. To avoid disagreements or problems with double taxation, banks require more precise legislation to handle matters involving interchange fees.
- Operational Adjustments: Banks should implement procedures like renegotiating contracts, rearranging transaction structures, and maintaining sufficient documentation to prove tax compliance in order to reduce risks.
- Impact on Financial Systems: In order to accurately monitor and pass on GST for complicated service arrangements like issuing and purchasing banks, the banks may need to upgrade their accounting and IT systems.

VII. CONCLUSION

While the Goods and Services Tax is a double-edged sword in terms of the banking industry, it has also ensured the smoothness and coherence in taxation through streamlined tax structures with full transparency. The imposition of GST in India has impacted the banking sector both positively and negatively. On the positive side, GST has simplified the tax structure; eliminated the cascading effect of taxes and created an opportunity to improve operational efficiency in some areas. On the negative side, increased compliance burden, conflicting and confusing registration requirements, and ambiguity regarding taxation of financial services have created operational hassles for banks.

The banking sector must reevaluate the changes the government made owing to GST and, going forward, contribute massively to tax compliance at great expense through efficient implementation and training of staff on the ropes of GST. Therefore, the government should clarify more so on the scope of GST concerning banking services with respect to inter-branch transactions and multi-party financial services. Nonetheless, uniform tax rates and no-cascading tax features form some of its strong attractions.

The Commissioner of GST and Central Excise vs. M/s Citibank N.A. evidence serves to illustrate the need for a clearer legal framework for the taxation of financial services. This case is the first of its kind to provide an interpretation of the GST laws for banking services and provides a guiding compass to other financial institutions facing similar predicaments.

REFERENCES

[1] Revathi R., Madhushree L. M., & P. S. Aithal. (2018). Impact of GST on the Indian Banking Sector. International Journal of Case Studies in Business, IT and Education.

[2] Sharan Kumar Shetty, Cristi Spulbar, Ramona Birau, Petre Valeriu Ninulescu. (2022). Investigating the Impact of Goods and Service Tax (GST) on the Banking Sector with reference to selected banks in India. Revista de Științe Politice. Revue des Sciences Politiques.

[3] B. Savithri. (2018). GST it's Impact on Banking Sector. International Journal of Research and Analytical Reviews.

[4] Revathi Radhakrishnan, Madhushree L. M., P.S. Aithal. (2018). Case study on the impact of Goods and Services Tax on the Banking Sector.

[5] P. Javin Prija, Dr. P. Asha. (2022). Indian Banking Sector - Issues and Challenges on GST in Nagercoil Town. International journal of Creative Research Thoughts.

[6] Kamruddin Shaik & Misab Pt. (2018). Impact of GST on Banking Sector: An Overview. International Journal of Research in Management & Social Science.

[7] PWC. (2021). Tax Insights.