A Year after GST

The Statesman

July 22 - 23, 2018

(I)

The new Goods and Service Tax (GST) regime that was launched on July 1 2017 with great fanfare has now completed a year- a period that has seen much upheaval in the Indian economy. A year is rather a short time to evaluate a complex, disruptive and transformational tax reform like the GST. Only a naïve person could have expected that creating a country-wide, unfragmented and unified market by eliminating the cascading of taxes and freeing the movement of goods and services throughout the country by removing all entry barriers would not exact its prices. These came in the form of disruptions and inconveniences to various sections of dealers, manufacturers and exporters, numbing pains for the informal sector everywhere, decline in economic growth, soaring inflation in the immediate aftermath of its launch and several shocks to the economy. All these are essential attributes of the creative destruction process a transformational reform that fuels innovation and growth entails everywhere – they were not unexpected and fortunately proved to be temporary. The past year indeed has seen many more downsides than upsides for the new indirect tax regime and invited constant criticism from the political opposition as well as others, but by now everyone has probably realized that GST has come here to stay, and not to be rolled back like what Malaysia has done for very different reasons. Since the old order has changed irreversibly, it is also time to look back, take stock of the implementation glitches, and formulate pragmatic and appropriate strategies for the future.

Experts and even government officials have been pointing towards the urgent need to effect various changes in the GST architecture like doing away with the 28% tax bracket and moving towards fewer tax-slabs by converging 12% and 18% rates, bringing in petroleum products, real estate sector and electricity under its ambit in a phased manner and simplify the compliance by doing away with so many returns to be submitted at so frequent intervals, besides improving the robustness of anti-evasion measures. All these are desirable, but may be easier said than done. However, some issues need urgent attention if we are to leverage the potential of GST to accelerate the growth of our economy in short to medium term, even though India's biggest tax reform will remain a work in progress for quite some time yet.

The compliance has been simplified to a large extent by dispensing many of the returns originally envisaged, but it is still beset with the problems of refund and the steady accumulated under the Integrated GST (IGST) levied in respect of inter-state trade and imports (exports are zero rated under GST). Although 13 returns (12 monthly and one annual) are prescribed under the GST, there are basically three monthly returns (GSTR-1, 2 and 3), plus an annual return GSTR 9, meant for most resident taxpayers. While GSTR-1 includes the details of outward supplies of taxable goods and services, GSTR-2 includes the details of inward supplies of taxable goods and services for claiming input tax credit (ITC). GSTR-3 is an auto-filled return generated by the software system after matching the details of GSTR-1 and GSTR-2 returns and forms the basis for refund and adjustment of ITC. Since matching of data between GSTR-1

and GSTR-2 was plagued with various problems, primarily arising from incorrect entries by dealers and buyers that made matching impossible, for making the transition to the new tax regime easier for the taxpayers, a simple return in the form of GSTR 3B was introduced as a temporary measure while keeping on hold the requirement of GSTR-2 so that refund of ITC could be made by using GSTR-1 and GSTR-3B. But the problem was not resolved and compliance still remains incomplete without matching between GSTR-1 and GSTR-2. Government is now thinking of making the return system simpler – one possibility being considered is to switch over to quarterly returns instead of monthly - but the details are still to be worked out.

Part of the problem is the GST Network (GSTN) which provides the technological backbone of the GST architecture that drives the new tax regime, which apparently is yet to develop its full capacity to respond to problems in real time and to handle the volume of transactions that it is encountering. The Union Finance Secretary admitted as much when, speaking at a session on “One Year Journey of GST” organised by Federation of Indian Chambers of Commerce and Industry (FICCI), he said that technology had failed us rather than people. FICCI in fact has just conducted a survey of enterprises on their experiences through GST implementation, according to which 59 per cent of the respondents were not satisfied with the capability of the GSTN portal and 96 per cent respondents wanted improvements in it, pointing to various deficiencies like lack of robustness and volume handling capacity of the GST Portal, delayed reflection of updated data as well as payments, absence of effective mechanism to resolve issues, inability to make corrections after submission of returns in case of errors, etc.

The government has envisaged over Rs. 90,000 crore a month to make up for the revenues earned under the earlier indirect tax regime and to compensate the states for any losses due to the new GST regime. Though the Union Finance Minister had expressed the hope that the collections would exceed Rs. 1.1 lakh crore every month in the new fiscal – a 20% rise in the average monthly collections as of now - to meet the budgetary target of Rs. 13 lakh crore, to achieve this will not be easy. He would need to widen the tax base, rationalize the tax structure, and strengthen enforcement to check evasion.

GST may have eliminated the odious Inspector Raj of the previous tax regime, but it has not yet ended tax evasion as was anticipated earlier. Indians in general are clever enough to beat any system when it comes to payment of taxes. Checking evasion is precisely the objective behind introduction of e-way bills and the proposed introduction the reverse charge mechanism from October 2018 that will help track transactions. These two steps together are expected to boost collections under GST by 25 percent.

E-way bill system was launched on April 1 for inter-state movement of all goods worth Rs 50000 and above. The requirement of e-way bill for intra-state movement of goods was launched in a phased manner beginning April 15. Introduction of e-way bills will enable the states and the Centre respectively to track intra and inter-state movement of goods and hence check evasion; to clamp on cash based trade will be one of its targets.

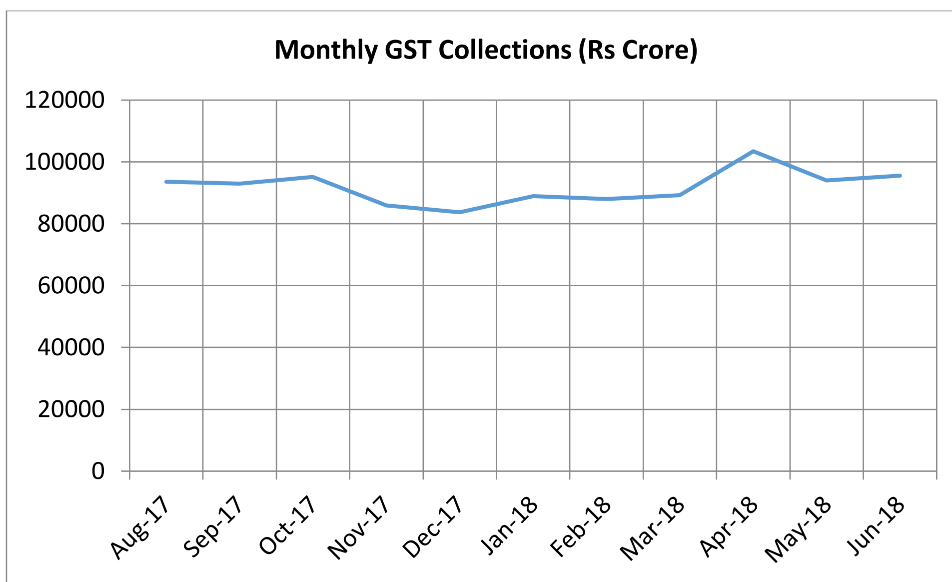
As regards the other measure, usually it is the seller of goods or service who pays the tax. But under the reverse charge mechanism, the receiver has to pay the tax and the chargeability of tax gets reversed. The mechanism was originally envisaged under the GST Act to help small suppliers who may be unregistered but supply goods and services to registered dealers who are unable to claim the ITC as they are buying from unregistered dealers, but by paying the tax on behalf of their unregistered supplier, they become

eligible to claim the ITC. The problem is that the tax is to be paid upfront by the buyers but credit claimed later, leading to blocking of working capital and distorting the seamless flow of input tax credit through the GST system. But the absence of such mechanism would threaten the survival of the small units that will be forced to register with the GSTN, which will raise their compliance costs enough to eat into their small margins. Under protest from traders, the government had suspended the move till first March 31 which was extended till September. Government is now thinking of finally introducing it from October, but for successful implementation, the genuine concerns of small dealers, traders and manufacturers need to be addressed.

In fact, the suspension of reverse charge and invoice matching as well as a deferred rollout of e-way bills are reckoned as reasons for bringing down the GST collections sharply in November and December 2017 from the levels seen immediately after its launch.

(II)

Collections from the GST have so far been heartening. Between August 2017 and March 2018, Rs. 7.19 lakh crore were collected under the GST at an average of Rs. 89,885 crore per month, which included Rs. 1.19 lakh crore of Central GST (CGST), Rs. 1.72 lakh crore of State GST (SGST), Rs. 3.66 lakh crore of IGST (including Rs. 1.73 lakh crore on imports) and Rs. 62,021 crore of compensation cess (including Rs. 5702 crore on imports). Compensation cess is levied on sin and luxury goods for raising the funds to compensate the states for any possible loss of revenue. Compensation is required to be paid the states to protect their revenues from taxes subsumed in the GST at the level of 14% growth over the collections of 2015-16. While GST on domestic supplies pertaining to a month is collected and accounted for in the next month, IGST and cess on imports are collected in the same month. Including the collection IGST and cess of July 2017, the total GST collection during the eight months of the financial year 2017-18 since its launch stood provisionally at Rs. 7.41 lakh crore.



The SGST collection during these 8 months, including the settlement of IGST, amounted to Rs. 2.91 lakh crore and the total compensation released to the states for this period was Rs. 41,147 crore, leaving Rs

20000 crore of compensation cess still undistributed. The revenue gap of each State – the shortfall of collections under GST from the expected growth – has been declining every month and the average revenue gap of all states stood at 17% at the end of March 2018. The number returns filed by taxpayers, which is an indicator of compliance, has increased from 59 lakh in July 2017 to about 65 lakh in March 2018, but it is still far short of over 1 crore taxpayers registered with the GSTN (64 lakh earlier indirect taxpayers who migrated to GST and 38 lakh new registrants). This remains a problem and point towards the possibility of tax evasion. Around 18 lakh of these taxpayers are registered under the composition scheme for small traders that comes with a flat tax liability and low compliance, and can serve as a conduit for evasion.

The total GST collections stood at Rs. 94610 crore in May, 2018, and soared to Rs. 95610 crore in June, which included CGST of about Rs 16000 crore, SGST Rs 22000 crore and IGST Rs 49500 crore, the rest being on account of compensation cess. Taxes paid during March, reflected in April, shows a spike due to the normal fiscal year-end effect, but even discounting this, the IGST collections show an increasing trend while CGST and SGST figures remain more or less stable. While it indicates that inter-state trade is increasingly passing via the GST portal, it also creates a serious problem because much of the IGST so collected remain unallocated.

IGST is not a new tax but any collections under IGST need to be allocated between CGST and SGST depending on the matching of details submitted by the buyer and the supplier of goods and services located in different states. If details cannot be matched, the amount remains unallocated. Thus in June, of the total IGST collections of Rs. 49498 crore, Rs. 15968 were allocated to CGST and Rs. 14662 crore to SGST leaving Rs. 19159 crore as unallocated balance. The unallocated IGST balance has been accumulating over the past 12 months and has reached Rs 1.81 lakh crore by now. The IGST Act does not envisage what needs to be done in such a situation. But the Centre had decided to devolve Rs. 50,000 crore to the states in June, following the Finance Commission formula for devolution, in addition to the earlier provisional settlement of Rs. 35,000 crore made in February 2018.

The brilliant minds that had crafted the GST architecture and drafted the related statutes should have given a little thought to the fact that to roll out such a hugely complicated tax system driven entirely by technology was likely to create problems with dealers and traders who may not have touched a mouse or keyboard ever before in their lives, and provided for an easier and more user friendly alternative. They should also have recognized the problem of spillover of unadjusted amounts from one accounting year to the next. Fundamentally it is not different from what used to happen earlier in relation to the Central Sales Tax, which has now been subsumed in the IGST. Accretion and apportionment of IGST would always be an ongoing process and this fact needs to be recognized in the Act itself.

Article 269A of the Constitution which provides that GST on inter-State supplies and imports shall be levied and collected by the Union and apportioned between the Union and the States does not create a new tax, but only provides a mechanism for collection of CGST and SGST in the case of inter-state trade and imports. IGST thus is not a different tax – part of it goes to the Consolidated Fund of India as CGST and the rest – more or less equal in amount – goes to the Consolidated Funds of the States, where the supply of goods and services have occurred, as SGST. To keep the proceeds of IGST in the Consolidated Fund beyond a year or transfer the unallocated balance to the Public Account or any other account would be grossly

illegal and unconstitutional. Pending their allocation, collections from the IGST are presently parked temporarily in the Consolidated Fund of India. The IGST Act does not provide for the eventuality that the collections from IGST may remain unapportioned beyond a year. In such case, the only viable alternative would be to treat the entire unallocated amount as CGST and take it to the Consolidated Fund of India, pending final adjustments. Once treated as CGST, 42% of the net proceeds would automatically devolve to the States. Even though the adjustments might take some time, this will ensure that the States would get some of their dues at least in time.

The GST Council has a Constitutional status, having been provided for in the Constitution itself. Section 25 (1) of the IGST Act provides that the Government will act according to its recommendations in case of any difficulty during the next three years, of which one has already passed. The remaining two years should be judiciously utilised to identify intractable problems like this, zero on the most pragmatic solution and make necessary amendments to the Acts. The problem of unapportioned IGST demands urgent attention of the Council.

GST has been one of the most ambitious and path-breaking economic reforms ever undertaken in the country's history. A disruptive reform of such monumental complexity has never before been attempted in our country. Among the few countries that have attempted such reform, none can come near to India in terms of the complexity of federal structure, size and population, and the stupendous amount of diversity and asymmetry between its constituent parts. No wonder it has taken us nearly three decades of strenuous efforts to implement this transformational reform by working out a rare consensus in our political democracy.

Besides killing the Inspector Raj, GST has nudged a large part of the informal economy into the formal stream as seen from the high volume of about 40 lakh fresh registrations. Formalisation alone can give access to capital, skills and technology, and of course social security – presently all these are denied to the small dealers. The entry of 40 lakh new entities in the country's tax net will also help increase direct tax collections. Despite reducing the rates of GST on a host of goods ever since its launch and bringing the number of goods under the 28% bracket from 200 to only 50, collections have not decreased; in fact they have remained rather buoyant.

No tax system could claim to be flawless, and GST indeed has its own drawbacks and shortcomings. We only need to address them systematically and gradually so that the pains do not neutralize the gains. After all its turbulence and disruptions, maybe we are just beginning to reach the threshold when the benefits start outweighing the costs. The challenge is now to leverage its advantages to transform our economic landscape by setting the creative potential of our entrepreneurs and businesses free.