Influencing Resource Allocation Efficiency-the Big Bang Indirect Tax Reform

– Moving up the rank of Ease of Paying Tax and Ease of Doing Business

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Efficient tax system and use of technology for administration enhances efficiency of allocation of resources and is one of the key influencers of investment decisions, both national and global. World Bank Group measures tax system efficiencies on parameters of number of taxes, tax rate and amount, time for compliance both, pre and post filings. India ranked 119 out of 190 economies assessed by World Bank Group in its 2018 report on Paying Taxes indicator, up from 172 in the 2017 Report. Major influencer for this upward movement was Introduction of electronic payment and filing system during 2016/17.

Paying Taxes and reforms in other indicators enabled India to move on Ease of Doing Business ranking as a whole, from position 130 to 100 in World Bank Group 2018 Report.

Implementation of wholly electronically administered new tax system, the Goods and Services Tax (GST), from 1 July, 2017 promises to be a marked improvement over the pre-GST indirect tax system.

What makes it so and how does it fare on each of the parameters used by World Bank Group in assessing Ease of Paying Taxes?

Implementation of GST in India

Introduction of GST in India, a country with federal structure, where Central and State Governments were imposing taxes on goods and services on the strength of taxing powers derived from Constitution of the country, through different statutes and at varying rates, with different levels of development, having separate exemptions based on States' needs, separate procedures for administration, check posts to monitor movement of goods within and outside the states and so on, was a massive challenge.

And, all of them, Central Government, 28 State Governments and 7 Union Territories, agreed to a common tax platform and also abide by decisions of GST Council, a forum with representation of all with the objective of achieving a most efficient tax system.

GST Impact

Current indications are that the design of GST with common rates and classification across the country, smooth flow of input tax credits across states through unique Integrated GST model, abolition of check-posts between states and its replacement by electronic way bills and administration through electronic system, Goods and Services Network, has reduced transportation and holding time and costs as also tax compliance costs. Supply chains are now tax agnostic. Businesses have started experiencing benefits of resource allocation efficiencies based on commercial rather than tax considerations.

Government's tax revenue is also expected to go up as GST settles down (it is work-in progress at present) especially, income tax on account of self policing mechanism and greater reported incomes. This will lead to overall growth of economy and capital markets.

Perceived adverse effect of GST on inflation remained in check. This was facilitated by the tax rate determination, vigil mechanism, especially, by consumer activists and, anti-profiteering mechanism.

Overall, the mood is upbeat; efficiencies derived from new indirect tax system, the GST, will boost trade and economic growth and will have positive influence on capital markets.

Where are we and what next?

A review of what we have achieved on each of the indicators[1] used by the World Bank Group for assessing Ease of Paying Taxes and what more we can do will indicate that we will certainly move up several ranks on the parameter of Ease of Paying Taxes and, consequently, on Ease of Doing Business.

Number of Taxes

These have shrunk significantly, both principal and other taxes – Central Excise Duty and Service Tax at the Central Government Level, State Value Added Tax and Entry Tax at State Government Level, Octroi Duty at the Local Government Level besides Entertainment Tax, Luxury Tax and so on. All these replaced by one, Goods and Services Tax, a destination based, value added tax, with two components; Central GST and State GST.

Cascading of taxes is addressed as, tax on tax, in respect of these taxes is removed. Taxes on inter-state movement of goods is also now fully creditable so, cascading on that count is also removed.

Tax Rate and tax amount

This area is work-in-progress. The rate of GST for goods was arrived at by adding the applicable Central Excise Duty Rate and State VAT rate applicable to the concerned goods and all goods were placed in baskets of Nil rate, 3 % rate (for precious and semi-precious metals and ornaments and like), 5%, 12 %, 18 % and 28 %. Given India's diversity, we did need more than one rate. We have two standard rates – 12 % and 18 % with a view to ensure that gap between lower and upper band is not very high so as to achieve better compliance.

However, the rates applied to different products did create huge heartburn since, pre-GST, effective rate on several of these products was in the range of 12-15 % varied from State to State) on account of threshold exemption from Central Excise Duty of INR 15 million for small manufacturers. Threshold under GST is INR 2 million. Economic activity was also severely impacted in early days of GST implementation on account of this coupled with after effects of demonetization. Some of this was corrected and rest is being done step by step after weighing revenue implications.

On services front, tax rate was uniform at 14 % + Cesses 1 %=15 % in pre-GST regime. For most services, this rate went up to 18 %. This too caused discontent.

In addition, to meet Central Governments obligation to compensate State Governments for possible loss on account of GST introduction (this was agreed as it was not possible to determine what could be the impact of uniform GST implementation across the country and concerns of manufacturing states that the revenue may move to consuming states), it was agreed to charge Compensation Cess on demerit goods like motor vehicles, cigarattes,etc.

While standard tax rate for service is 18 %, an exception has been carved out for leasing services. Leasing services are taxable at the same rate as the goods that are leased. As a result, for motor vehicle leasing business, lease rental, which could comprise several components, usage charge, interest, registration charge besides installment is also being charged at the same rate, including compensation cess, as is applicable to vehicles. This anomaly crept up since there was a concern that if the rate for leasing service of motor vehicles is standard rate of 18 %, manufacturers of motor vehicles would not sell but, opt for leasing leading to significant lower revenue generation from this sector as compared to the projected revenue considered for working out rates.

Compliance Time

Compliance time depends on the simplicity of law and procedures and the key components of this process are:

- Determination of tax liability
- Tax payment
- Tax filing
- Guidance, education, training and clarifications for compliance

Determination of tax liability

The Act, Rules and Regulations determine tax liability of a person. While basic tax structure is in place, there are several areas where amendments and clarity are required. Some of these have been considered at the GST Council meeting held on 21 July 2018 and, will ease burden in these areas and clarity. Yet, a lot needs to be done. Take for example, sale/transfer of a business as a whole as going concern. This is placed in the schedule of services with tax rate as NIL. Then, there is another provision which states that a business may transfer unutilized balance of input tax credit relating to the business that is sold or transferred to the buyer / transferee. But, since the sale/transfer is an exempt service, question of working out and disallowing proportionate input tax credit (taxable and exempt supply) arises. Appropriate amendment and clarification in this area is awaited.

The one big area of pain point was the domestic reverse charge mechanism which was introduced to address possible evasion. The one, where the registered tax payer is required to pay tax when it purchases goods/ services from unregistered person, had caused huge practical challenges and the applicability of the provision was postponed and, the provision will now be removed as per decision of the GST Council at its meeting of 21 July, 2018. Such reverse charge will now apply only in specified cases where there is belief/information as to evasion. Then there are other provisions of domestic reverse charge e. g. when a person obtains services of legal firms, the recipient of service is required to pay GST and the legal firm is neither required to register nor comply with any provisions. This adds compliance time and cost for the recipient of service and costs incurred by the legal firms do not move in the supply chain as they do not have obligation to pay tax.

The determination of tax liability thus, consumes fair degree of time of the senior management as well.

Tax Payment

This process is fully electronic and quite smooth. The early challenges of the electronic platform have since been resolved and it is an outstanding achievement considering the vastness of data that the network (GSTN) has to deal with and also, the fact that every taxpayer is not tech savvy. Most taxpayers, especially, the small and medium ones have got there and rest are being helped to reach there.

The pain point here is the non-availability of rectification module. So, if one has paid, Central GST as State GST or as Integrated GST, currently, there is no ability to do the correction. If excess amount is paid, that also can be adjusted in later months but, cannot be refunded. This issue is being addressed – is work in progress.

This area now consumes least time.

Tax filing

Tax filing is entirely electronic, A highly ambitious program was drawn up and worked on by the IT Network (GSTN) where a person was required to file return for outward supplies, that data would be populated in purchasing person's ledger, the purchasing person could verify that, accept or reject it, it could be corrected by both and ITC would be worked out on this basis and final return based on all accepted numbers would be filed. The tables in the return form are, by and large, user friendly except for some for job work which is being examined for simplification.

However, the matching of data did cause challenges and so a simplified return form (3B) was worked out and now a new return filing system has been worked out and approved by the GST Council in its meeting of 21 July, 2018. With these changes, major challenges will be addressed. There are few sector specific challenges, especially job work related and so on which is work-in-progress.

This area, for small tax payers consumes little time and for larger ones, it does take longer but, software is now in the market which facilitate tax filing. However, considering the volume and complexities, it is taking fair degree of time at present. More experience and stabilization of return forms and data matches will reduce time for compliance significantly and also address evasion challenges.

Guidance, education, training and clarifications

Several programs across the country were held for education and training of tax officers and businesses and have yielded results. This is an ongoing exercise and is happening.

Guidance is being issued from time to time and, here again, more could help.

The area of concern is clarifications and advance rulings. Most advance rulings have revenue bias and appeals against them also lie to the departmental officers. So these decisions too appear to have revenue bias. There is no provision for further appeal after Appellate Advance Ruling decision. This is not serving the purpose of providing clarity and reducing litigation. In fact, several writ petitions had to be filed and are pending for decisions. This area, thus, requires urgent attention to bring in clarity and certainty especially, since interest and penalty are very stringent and businesses will not be able to afford such high interest cost and/or penalty for areas where clarity is required and sought. Compliance with negative positions while awaiting decision with no visibility as to the time lines is also not a viable option.

This exercise of seeking clarifications and follow up is taking up time and adds to the cost of compliance too.

Post- filing compliance time

This has to commence and one would have to wait and watch. Current indications, based on some of the notices received on data analysis by the tax administration, are that this area would consume significant time and resources.

Overall

All in all, GST is huge improvement in all areas as compared to the pre-GST indirect tax regime. Such a massive reform in a country of India's size and diversity does take time to settle down and that is happening. Mind-set change of all stake holders and especially, tax administrators, coupled with a more business friendly attitude of facilitation of tax payment and compliance and minimum penalization, will go a long way in smoothening the progress and reaching the goal much faster than it would have taken for any other economy comparable to India.

There is no doubt that India's GDP will receive a boost as businesses and economy will benefit by efficiencies in resource allocation arising from a more efficient indirect tax system; India, in next assessment by World Bank Group, will move up several ranks on Ease of Paying Taxes and on Ease of Doing Business.

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[1] number of taxes, tax rates/amount, pre-filing compliance time (payments, filings) and post filing compliance time.