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Goods and Services Tax- A Six-Year Impact Analysis

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Abstract

This research paper is a comprehensive report on the Goods and Services Tax, introduced in India in 2017, while measuring its impact through an industry agnostic model over the past 7 years. This paper has been written after thorough analysis of several primary and secondary sources of literature, and builds on them to put forth a holistic impact analysis of the GST. At the outset, the paper hypothesized that the implementation of GST has had a positive impact on the Indian economy. Our findings have partially proved our hypothesis. While the GST has surely benefited the economy, loopholes in its implementation cannot be ignored. This paper explores various facets of the indirect tax, identifies its flaws and provides suggestions for better implementation.

Keywords: GST, indirect tax, cascading, economy, sector, MSME, gaming, revenue, VAT.

I. Introduction

The Goods and Services Tax, introduced on July 1st, 2017 is a revolutionary paradigm shift in India's indirect tax regime. The past tax structure was fragmented, with multiple taxes levied at different stages. GST unifies these fragments under a single umbrella, with the aim - One Nation, One Tax.

This simplified tax structure streamlines the complexities of indirect taxation, bolsters economic growth, eliminates cascading effect, promotes transparency and curbs tax evasion. Moreover, GST has also introduced the concept of input tax credit, thereby incentivizing compliance.

As this paper unfolds, we will delve deeper into the intricate components of the GST framework, elucidating its mechanisms, advantages, and challenges. By analyzing its impact across sectors and evaluating its role in shaping economic dynamics, we aim to unravel the multifaceted tapestry of GST and its implications for fiscal policy, trade, and business operations.

Abating the Cascading Effect

Perhaps one of the most significant stimulants to the adoption of GST by Indian policy makers was the growing need to attenuate the 'chain reaction' which had been imposing steady economic detriments to businesses and consumers alike. This refers to a grave loophole present in the incumbent indirect tax regime, which would result in a 'tax on tax' anomaly. Thus, the tax cascades down the line of distribution, inflating prices which consumers bear.

To elucidate this concept further, we must delve deeper into the types of taxes imposed withinthe previous indirect tax regime.

Tax	Taxable Event	Tax Collection Authority
Central Excise Duty	Manufacturing activity	Central Government
Service Tax	Taxable service	Central Government
VAT(Value Added Tax)	Intra-state transactions	State Government
Central Sales Tax	Inter-state transactions	State Government

The GST gave adequate respite, as it brought all indirect taxes under the umbrella of a single tax. The GST further has been divided into the CGST and SGST (for intrastate transactions), IGST (for interstate transactions) and UTGST (for transactions concerning union territories). However, despite having bifurcations, it provides for the holistic 'Input Tax Credit (ITC)' which has helped in total elimination of the viscous cascading. This differs from the erstwhile set up, where tax credits could only be borne on the Value Added Tax- ie a seller could not claim rebate of excise duty against the VAT.

Here is a working comparison between the cost of good A in the Pre-GST and Current system.

Assuming,
GST on good A= 18% Central Excise Duty= 12.5%
VAT= 12.5%
All transactions are intra-state

INR	Pre-GST System	Current GST System
Manufacturer		
Cost of Goods Produced	10,000	10,000
Add ED @12.5%Add GST @18%	1,250	1,800
Selling Price	11,250	11,800
Distributor		
Cost Price	11,250	11,800
Less Input tax Credit(only on GST)	0	1,800
Add Profit Margin	5,000	5,000
Basic Price (exclusive of tax)	16,250	15,000
Add VAT @12.5%Add GST @18%	2,031	2,700
Selling Price	18,281	17,700
Retailer		
Cost Price	18,281	17,700
Less Input VAT CreditLess Input GST Credit	2,031	2,700
Add Profit Margin	2,000	2,000
Basic Price (exclusive of tax)	18,250	17,000
Add VAT @12.5%Add GST @18%	2281	3060
Selling Price	20,531	20,060
Consumer		
Total Cost	20,531	20,060
Total tax paid	3,531	3,060
Effective Tax Rate	21%	18%

Consider the case of the distributor, who has not received a credit against the excise duty paid to the manufacturer. Therefore, VAT is added to the amount inclusive of excise duty, thus resulting in a 'tax on tax.' Mitigation of this issue through the GST system has resulted in reduction of burden on both producers and the end-consumers.

Increase in net government revenue

From the above analysis, it would be veracious to conclude that the introduction of GST has led to a decrease in costs which the end-consumer bears. In a play of rudimentary microeconomics, a decrease in prices has led to an increase in quantity demanded, thus increasing consumption within the economy.

Let's consider Consumer A, who wants to buy a 32 inch television which costs Rs. 20,000 excluding taxes.

Earlier, though the tax rate was 12.5%, owing to the cascading of taxes, the effective rate became say 21%. Therefore, cost amounted to-24200

Now, the GST rate is 18% and the product costs only 23600. This makes the same television more affordable.

As goods become cheaper, the tax base widens since more people consume products they earlier

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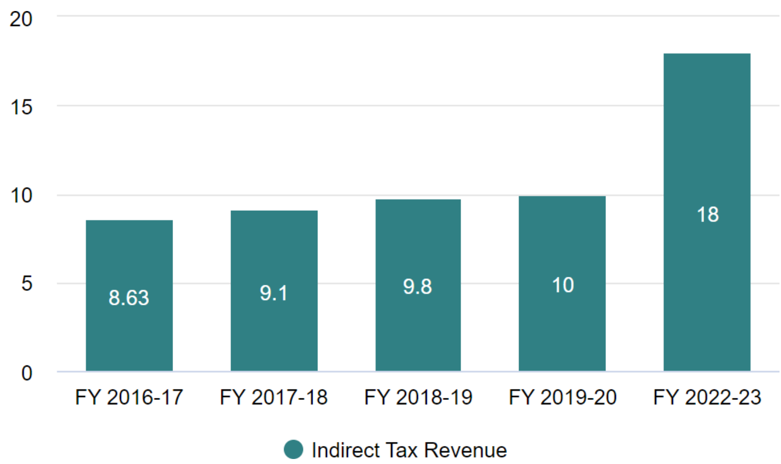
would have refrained from purchasing. This in turn increases government revenue.
Quoting Nirmala Sitharaman, our honorable Finance Minister, “four years into GST, our tax base has almost doubled from 66.25 lakh to 1.28 crore and every month GST collections are crossing RS. 1 lakh crore.”[1]



(All values are in lakh crore)
Based on data from Press Information Bureau, Government of India[2]

Viewing this scenario analytically, the GST system has successfully managed to reduce the burden of taxes borne by the consumer while at the same time bolstering the income of thegovernment.

Ease of doing business:

While the primary activities of businesses involve creating sustainable supply chains, enlarging customer base, biting off competition, etc, they also have to comply with a number of regulatory processes such as obtaining permits, registration of business, securing credit, and paying taxes in order to conduct business smoothly. The ‘Ease of Doing Business’ (EOBD) Index is a rank provided to countries by the World Bank to measure how conducive it is to carry on business in the country. Higher rankings indicate less cumbersome compliance mechanisms.

India was placed 142nd out of 190 countries in 2014. However, India steadily moved up the rating ladder after implementing GST and was ranked 77nd in 2018, rising to 63rd in 2019.

To understand this better, we must analyze the contrast between the Pre-GST and post GSTsystems.

In the Pre-GST regime, multiple indirect taxes were levied such as Sales tax, VAT, Excise duty, Service tax, etc. Greater number of taxes result in greater number of returns, assessments, refund claims and credits thus increasing compliance costs and time. Due to different tax laws, businesses were forced to hire more personnel conversant with the laws. The old tax system lacked uniformity as each state imposed different taxes at different rates. This resulted in complex supply chain bottlenecks which are elaborated under the logistics section. Under the previous regime, as every state had different tax rules, businesses would have to register for VAT with each state’s sales tax department in order to carry out business activities there and also pay multiple procedural fees for VAT registration if the business was established across multiple states.

GST has subsumed 17 indirect taxes and 13 cesses reducing the time and costs of compliance by a whopping 75%. The automation of the entire tax return filing system has resulted in simpler compliance, faster refunds and increased transparency. A single tax for the entire nation has removed regional imbalances and inter-state barriers ensuring quicker movement of goods across state borders. Under GST, the registration is centralized and the rules are uniform for all the states across the country. The net effect- decrease in expenses and more time to focus on the critical activities of the business.

The table below indicates the contrast in tax compliance in the Pre-GST and post GST regimes.

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Compliance Simplification in GST

Pre-GST [Excise+VAT]*	FormType	InGST
317	Annexure	0
12	Challan	1
32	Declarations	0
122	Forms	11
2	Transit pass	0
4	Worksheet	0
5	Invoice format	0
1	Register	0
495	**Total**	**12**

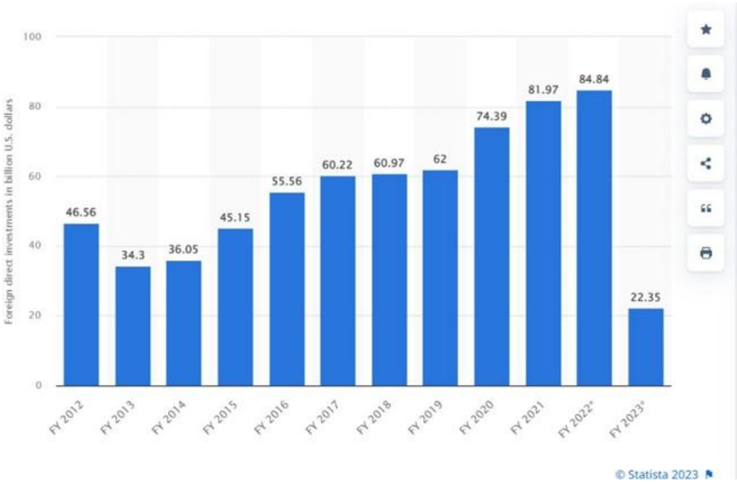
Based on data from Press Information Bureau, Government of India[3]

Implications of improving EODB rank:

1) Foreign Direct Investment (FDI)

FDI is a category of cross border investment made in a company or project to acquire a controlling stake in the asset. The inflow of FDI results in economic growth and development as jobs are created and exchange of technology and knowledge takes place. As a developing nation, FDI is an integral component of our capital accounts in order to attain high GDP growth. The inflow of FDI is affected by multiplicity of factors such as political stability, exchange rates, wage rates, etc. However, the tax rates and ease of doing business in a country are major determinants.

Due to multiple factors at play, the impact of GST on inflow of FDI cannot be ascertained accurately. However, it can be extrapolated that due to improvement of EODB, reduction in cost of production and compliance and elimination of logistical bottlenecks in the GST regime, India has developed into a favorable location for investment.



The graph above shows the rising trend in inflow of FDI since 2017. [4]

2) MSMEs

MSMEs refers to Micro, Small and Medium Enterprises. They are small economic engines and have a huge impact on the country's GDP. They are referred to as the backbone of the Indian economy as they contribute 30% to the country's GDP, around 45% of the manufacturing output, and approximately

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48% of the country's exports. This sector employs more than 110 million people both in the rural and urban areas. Therefore, it is imperative to support MSMEs through simpler policies. Currently, MSMEs face several challenges, most profound ones being lack of adequate finance and tax compliance. A simple tax structure would alleviate many woes of this sector.

Moreover, a composition scheme has been introduced under GST to reduce compliance and tax liability of small businesses. The features of the scheme:-

- MSMEs earning a revenue of less than Rs. 1.5 crores (for manufacturing entities) and less than Rs. 5 lakhs (for service providers) are eligible to register under this scheme.
- Businesses need to pay a fixed rate that ranges between 1% - 5%.
- Taxpayers are exempted from filing monthly returns, they need to file only quarterly returns.
- No input tax credit is available on supplies.

3) Exports

The price of the goods after levying custom duties, on now cheaper products will be lower than that of the previous tax regime. This has improved the competitiveness of Indian goods in foreign countries. It can be concluded without doubt that the implementation of GST has led to a rise in exports which will in turn have a positive impact on India's Balance of Payments and Balance of Trade.

Sector specific impact analysis:

Case Study A: Logistics sector

The logistics sector is an indispensable part of a country's economy. It boosts economic growth, increases exports and generates employment. Logistical inefficiencies lead to supply chain bottlenecks which result in slowdown of profits and impacts consumer satisfaction. The trucking industry holds a significant place due to the reliance of e-commerce and heavy cargo sector on it. The logistics sector in India is poised to grow at a CAGR of 15.5% which is higher than the BRICS average of 11%.[5] It currently contributes to 14% of the GDP. Thus, the economy will benefit with the reduction in inefficiencies in this sector.

The logistics sector was hurdled with massively inefficient tax policies in the previous tax regime. Firstly, there were taxes on the inter-state movement of goods and cross-state differences in VAT structures. Every state charged different taxes such as entry tax, VAT, Octroi, CSR. Secondly, there were cumbersome inspections at state borders. A World Bank-funded study, undertaken by the Ministry of Road Transport and Highways suggests that roughly 50-60% of the transit time was spent at the border on verification of documents.[6] This forced companies to create and maintain warehouses in each state resulting in each company establishing 20-30 warehouses.

The introduction of GST has eliminated the arbitrary taxes that were charged at state borders. The e-way bill is a breakthrough for the logistics industry. It is a document that is required to be able to facilitate the movement of goods. A registered taxpayer is mandated to generate an e-way bill to undertake transportation of goods exceeding Rs. 50,000. It can be generated on ewaybill.gov.in and aims to automate the exchange of receipts for permits.

The implementation of GST will benefit many facets of the logistics sectors. Delays due to roadblocks, tolls and other stoppages could cut freight times by some 20-30% and logistics costs by 30-40%, according to World Bank estimates. This could also boost the competitiveness of India's manufacturing sector by 3-4% of net sales.[7] The requirement of multiple warehouses will be eliminated. Companies could thus employ the Just-In-Time inventory system which would reduce the amount of cash flow invested in inventory. India has risen by six ranks on the World Bank Logistics Index since 2018.

Case Study B: Hindrance to the Gaming Industry

The gaming industry in India has been receiving increased traction from the masses as the sector booms with precipitous rates of consumption and participation. In fact, the industry which currently generates a revenue of $1.5bn is expected to witness a 4x jump to >$5bn dollar by 2025. While the budget released by the finance ministry put forth ambitions of an atmosphere conducive to the growth of this sector within the country, the GST council seems to have taken a regressive turn on this matter.

Online games can broadly be classified into those involving skill and chance. When the game entails a certain level of proficiency and expertise, it falls under 'skill', including those like Dream11, Rummy platforms etc. On the other hand, those based primarily on a factor of luck, come under the ambit of 'chance'. Earlier, 'skill-based games' attracted a GST of 18%, while 'chance-based games' were taxed at 28%.

However, there is always a very thin line where skill and chance abut, thus leading to a quandary about the classification. Hence, at the 48th GST Council Meeting, it was decided that a flat rate of 28% for all games would be applied henceforth.

Estimates by Financial Express[8] surmise that this will lead to a 50-53% increase in taxation within the sector, thus insinuating a negative impact on the future of gaming as an industry inIndia.

Illegal ProfiteeringCase 1:

Critics often target the irony of multiple tax brackets within GST, supposedly advertised as a 'one nation one tax' system. Since taxes levied are divided into the five broader groups of exempt, 5%, 12%, 18% and 28% it is said to promulgate complexity within the consumer base. Producers have well identified this as a loophole, and very often exploit it for illegal gains.

A similar case occurred with the Jubilant Foodworks, India's multi-million franchise of the Dominos Food chain.

Convening on November 15th, 2017, the GST council revised the rates on pizzas and garlic bread from the erstwhile 18% to a lower value of 5%. However, as per reports released by MoneyControl, between this date and May 31st, 2018, the food enterprise, surreptitiously, did not pass down this benefit to their consumers.[9] They continued taxing their 'medium veg pizza' and 'dominos stuffed garlic bread' at 18% and deprived consumers of benefits worth Rs.41.42 crore. [10]

In this case, the National Anti-Profiteering Authority (NAA), identified these illegal activities and subsequently ordered the company to pay the amount of Rs.41.42 crore with an interest of 18%, where 50% would go to the state governments and the other 50% to the center.

The Jubilant Case study is a reflection of the possibility of illegal methods being resorted to, with the intention of profiteering at the cost of the consumers.

Case 2:

Taxpayers found the input tax credit feature under GST to be very attractive. They now adopt illegal ways to claim inflated amounts of credit. Their modus operandi is two-fold.

Firstly, they issue fictitious bills of purchases to fabricate the actual amount of input tax paid by them. Through this they claim higher input tax credit on such bills. The second mechanism is the under-reporting of sales. This is done to under-represent the amount of output tax collected, thereby increasing input tax credit received.

In 2019-2020, the government rolled out the Automated Return Scrutiny Module (ARSM) in order to curb these rampant tax evasions.

The ARSM uses data analytics to identify risks and discrepancies in GST returns. This assists tax officers in scrutinizing the returns of taxpayers who are selected based on the risks identified by the system. The system also generates alerts if any non-compliance is detected.

E-Invoicing is another revolutionary mechanism introduced by the GST council. Under e- invoicing, B2B invoices are authenticated by the GSTN (Goods and Service Tax Network) for further use on the GST portal at the time of sale. An identification number is issued against every invoice by the Invoice Registration Portal (IRP), which transfers the invoice information in real-time to the GST portal and the e-Way Bill portal. With a uniform invoicing system, the tax authorities are able to pre-populate the return and reduce the reconciliation issues. It also aims at reducing the number of frauds as the tax authorities will have access to data in real-time.

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Before the implementation of the e-invoicing system, each business would use different websites to generate invoices. They would then have to fill the GSTR-1 and GSTR-2A forms. There were high chances of manipulation which is being tackled efficiently and is evident from the followingfacts:

The government netted close to □1.15 lakh crore in GST during December 2020. This can be owed to their crusade against tax evaders. The government initiated action against around 7,000 offenders and arrested 187 individuals who were caught in an offense of fake-invoicing. The tax evaded amounted to Rs. 40,000 Crore.[11]

Classification Conundrum

Indirect taxes are applicable on all goods and services produced or provided within the economy. The 'GST' which is an acronym to the 'Goods and Services Tax' is no exception. However, governments maintain that services need to be taxed at higher rates as compared to goods, which has been the case even with the GST. Thus, a pizza bought at a restaurant attracts a gst of 5% as it is treated as a good. On the other hand, the same pizza, if ordered online via Swiggy would be taxed at 18%, since 'delivery' becomes a service.

This distinction evolves into a predicament when the line where the definitions of a 'good' and 'service' abut begins to fade.

This is where the reader must be introduced to the concept of 'composite supply'. Many times, the supply of a good may involve cases of being both a 'good' and 'service'. In such scenarios, the tax is supposed to be aligned with the 'principle supply'. For instance, revisiting the pizza example- when pizzas are ordered online- pizza in its essence is a 'good' while the action of delivering this pizza is a 'service'. Since delivery is treated as the 'principal supply' the tax rate of a service is applied. But, then again, how do we legally determine what exactly amounts to 'principal'?

Recently, an Indian actor was charged an exorbitant Rs.442 for 2 bananas he ordered while residing at a hotel. The bill is supposed to have stated that the 2 unpeeled bananas constituted a 'fruit platter'. Bananas by themselves are exempt from GST, but a fruit platter would be treated as a service, thus attracting an 18% tax rate. Being another case of composite supply, this raises the question, what should be considered as the 'principle supply'?

Manufacturing States

GST has revolutionized inter-state transactions as it has led to large-scale simplification of logistics and transportation between different states of the country. However, it must be noted that the GST is a 'destination tax'. In the sense that the tax is always collected in the state where the goods are consumed. For instance, if a TV is produced in Kerala and sold in Maharashtra, then the tax can only be collected by the Maharashtra govt. Thus, manufacturing states are expected to take a big hit with the outset of GST.

Over the past decade or so, Tamil Nadu has invested extensively to develop themselves as a hub for the production of goods. However, with the provisions of the GST, states like TN will face a steep loss of revenue, with their investments being disregarded. In fact, in the session where the GST matter was being discussed, the then CM Jayalalithaa pointed out that the losses would be as high as Rs.9270 crore.[12]

The government promised that the center would provide compensations for all losses experienced for a period of 5 years from the date of enactment. This has now been increaseduntil the end of FY 2026.

Comparing India's model with the global scenario

Most countries today have an active and functioning GST/VAT model. As per latest estimates, 174 countries fall under this umbrella, with the United States being a notable exclusion.

However, the system followed elsewhere may differ widely from what we have been seeing here in India. While India has a federal structure, wherein the GST is collected separately by the state and the center, most countries have a unitary structure where either the center or state is responsible for collecting the taxes. Moreover, India's 5 tax slab system differs from other nations where most make use of a single or dual tax slab model. The same source corroborates that 49 countries currently use the single tax system and 28 countries have opted for the dual model. People often criticize the government for having undertaken a bifurcation model for the GST, which was brought about with the purpose of facilitating a nexus of the various taxes present erstwhile. However, this argument lacks merit, considering the demographic and economic indicators unique to our country.

Analysis: India vs New Zealand

Parameter	New Zealand	India
Number of tax slabs	1 tax slab- 15%	5 tax slabs- exempt, 5%, 12%, 18% and 28%
Average indirect tax rate ongoods and services	15%	11%
Tax to GDP ratio	34%	5.6%
% of population that paysincome tax	100%	6.25%

New Zealand has been chosen for the study, since it is stringent in the application of the 'single slab' model as opposed to India's '5-slab' system.

Critics claim that with 28% as its highest tax slab, India has proceeded to inflict one of the highest tax burdens onto its citizens. However, we must also observe that the average tax on goods and services remains at a low neutral of 11%. Considering the Indian economic scenario, where a major chunk of the population is riddled with poverty, it only makes sense to charge higher taxes on luxury products, so that benefits can be provided on essentials. In fact this is how economists believe that indirect taxes can be made more equitable.

India is perhaps one of the only countries where only 6% of our population pays direct taxes for the country to be run. This again is a result of the widespread economic regression prevalent in the nation. This reiterates the need for India to bolster her indirect tax earnings for a more 'equal' set-up in the system of taxation.

II. Conclusion

Through this study, our hypothesis has been proved correct. The paper first analyzes the intricacies of the GST structure. The methodology employed involves quantitative analysis, using hypothetical figures. The paper also delves into sectoral analysis focusing majorly on promising sectors such as the gaming, logistics and MSME. It discusses certain issues faced during the implementation of the GST regime and highlights the loopholes too. The paper provides a comparison between the structure in India and the global scenario. Thus, while this revolutionary mechanism has many positives, it is accompanied with downsides too, which can be overcome through fixing the loopholes.

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