RESEARCH NOTE ON

GST (GOODS & SERVICES TAX)

IMPLEMENTATION AND IMPACT ON UNORGANISED SECTOR, MICRO & SMALL ENTERPRISES : GURGAON

AND A 30 MONTH FACT-CHECK

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RELEASE DATE : 25th JANUARY, 2020

TENETS OF TAXATION POLICY IN "ARTHASHASTRA"

- COLLECT TAXES AS BEE COLLECTS HONEY FROM FLOWERS WITHOUT PAIN
- BROAD BASED, SIMPLE, FAIR, CONVENIENT, EQUITABLE & PREDICTABLE

ALL INDIA PROFESSIONALS' CONGRESS (AIPC)
GURGAON CHAPTER INITIATIVE

INDEX & ACKNOWLEDGEMENTS

ACKNOWLEDGEMENTS

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AND MOST IMPORTANTLY: MOTIVATIONAL NUDGES BY CHAPTER LEADERSHIP

*MOILITICS**:** An On Line Media Company in Gurgaon, which carries out Field Surveys through trained Student Evaluators

GST : INTRODUCTION

GST, as a concept, is one of the most acceptable and effective taxation methodologies around the world that transcends all political and ideological considerations and provides an ecosystem that reduces hassles of doing business, reduces the cascading effects of multiple taxes, and widens the tax base. However, its implementation is extremely tedious and complex. International experiences, in over 190 countries, have demonstrated that those countries that have successfully transitioned from their other systems into GST have done so over a period of time and involved extensive education, awareness programs to all stakeholders for their acceptance. Hongkong tried to implement GST for five years but it failed to earn the trust of the stakeholders and was compelled to revert back to the old VAT system.

In India, GST got bogged down for more than a decade due to strong opposition by political parties on both sides of the aisle. It was first mooted by the Congress-led UPA government as early as 2003 and announced in the LokSabha in 2005. After much debate and differences among parties it was finally passed by the NDA government on 3rd August 2016. It has been heralded as a landmark event for the country as it has been ushered in after almost two decades of effort. The GST exercise undertaken in India has no parallel in the world. It affects potentially 2-2.5 million tax entities, requiring deployment of the latest technology to use and test the tax implementation capability to its seams. Given the country's heterogeneous nature, complex political democracy, a culture of tax evasion, illiteracy and skewed economy, it is perhaps a unique experiment unprecedented in modern global tax history. Its success will be mainly due to the unambiguous political support to the concept across ideologies, the sheer grit and diligent determination to undertake this difficult and tedious journey.

Indian industry had been demanding the GST for a long time, primarily because of the predictability it will bring in taxes for goods and services across the country. Earlier, in India a variety of taxes were imposed on goods and services, including Central excise duty, state-level value added tax (VAT), service tax, purchase tax, luxury tax, entertainment tax and entry tax on inter-state movement of goods. All these now coalesce into a single tax rate for each good and service across the country. More predictability is expected from the same tax rate applied to broadly similar categories of goods such as luxuries and necessities.

Objectives of the Study

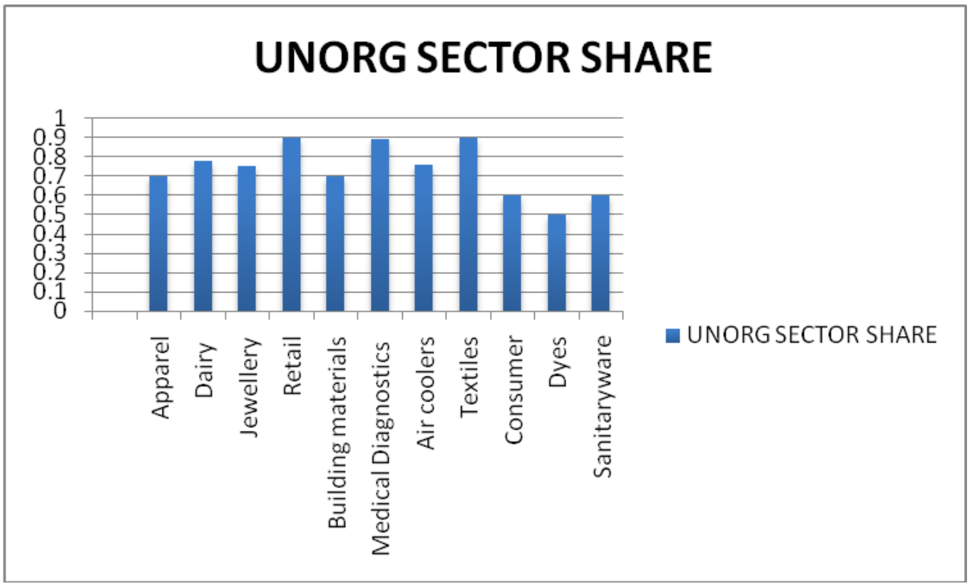
While much has been written on the architecture of the GST and many recommendations made to revise and improve it since 2017, there are fewer studies on the *impact* its implementation has had on Indian industry and the service sector. This paper is a modest attempt to understand the impact of GST particularly on small scale industry, over three years of its implementation. The paper is in two parts. The first is a report of a survey undertaken in early 2018 to examine the initial and immediate impact adoption of GST has had on micro and small-scale industry and services in the unorganized sector in Gurgaon, a principle city of Haryana. The survey showed that the implementation of GST in July 2017 soon after the adoption of demonetization had a disastrous impact on small businesses in the unorganized sector. Second, there was confusion particularly within this sector, due to lack of clarity, higher cost in computing GST, falling sales, cash flow pressures and loss of trust of customers. All this led to despondency, unhappiness and frustration among small entrepreneurs and service providers.

Against this backdrop, the second part of the paper analyzes the policy changes made subsequently, from time to time and their impact on small scale industry and services in the country, including Haryana. A key question underlying the paper therefore is, whether the many policy changes undertaken by the central government have been able to overcome the problems initiallyfaced by small industry and services in the country including Haryana. Has the policy stabilized or, is it still a work in progress with constant changes being mooted?

An important reason for our selecting the unorganized sector is the large number of media reports of the extremely negative impact this policy has had on unregistered small business and service entrepreneurs. The unorganized sector refers to those enterprises whose activities or collection of data is not regulated under any legal provision and / or who do not maintain any regular Accounts. For instance, the units that are not registered under the Factories Act, 1948 form the unorganized composition of the manufacturing sector. Despite this, the unorganized sector contributes to nearly 50% of India's GDP and 90% of employment. The report of the National Commission of Enterprises in the Unorganized Sector pointed out that in 2005 over 200 million livelihoods, i.e. 53 per cent of total 'livelihoods', (including those in agriculture), took the form of self-employment, smallholder production, own-account enterprise, household production, cottage industry or micro-enterprise (NCUES, 2009). However, most of the enterprises are not even small and medium in size (SMEs); they are "micro" enterprises with under Rs 25 lakh of investment for those dealing with goods and under Rs10 lakh for services. As per the Economic Census 2005, around 64.41% of all establishments are own account establishments, i.e. establishments without any hired worker. They form the most vulnerable section of the economy and have borne the brunt of the impact of GST implementation.

As figure 1 shows the unorganized sector plays a very major role in the economy, in a number of sectors embraced by the common man. Therefore, the impact of GST on this sector will determine the efficacy of the implementation and provide insights into some issues for midterm corrective actions.

Fig. 1



Traditionally, the unorganized sector thrived due to its price competitive advantage over the organized sector driven mainly due to the tax arbitrage that existed. While the organized sector had to comply with a lot of tax requirements, the unorganized sector operated under the radar. GST has now leveled all the taxes and skewed the advantage in favor of the organized players. Even as the traders, unorganized sector, micro and small industries were reeling under the negative impact of demonetization, they were confronted with the hasty implementation of GST which seems to have added additional burden on them.

In an effort to demonstrate the objective of widening the tax base, a number of informal sector enterprises have been forced to register into the GST. According to CAIT, nearly one crore traders may opt for the 'Composite Scheme' but will have to get registered under the new tax regime. Moreover, two crore small businesses that do not fall under any indirect tax law, will still have to comply with the new rule mandatorily. In Haryana, the unorganized sector formed over 40% of the State's GDP & offered Employment to over 78% of those employed.

<u>The Study: Scope and Methodology</u>:In order to study the impact of GST, the method adopted was to first study international experiences, identify major drivers and Government objectives of GST and prepare a Questionnaire for the survey. Critical factors were culled out to study the impact of GST during the first 9 months of its implementation.

The main objectives of the Indian government in implementing GST is to eliminate the cascading effect of multiple taxes and to introduce transparency, mobilize revenues and reduce fiscal deficit, reduce price for consumers, provide traceability of transactions and convert the country into *one unified market*. Considering that it is being done after 190 countries have adopted GST, there are lessons that can help us guide the effort, as below.

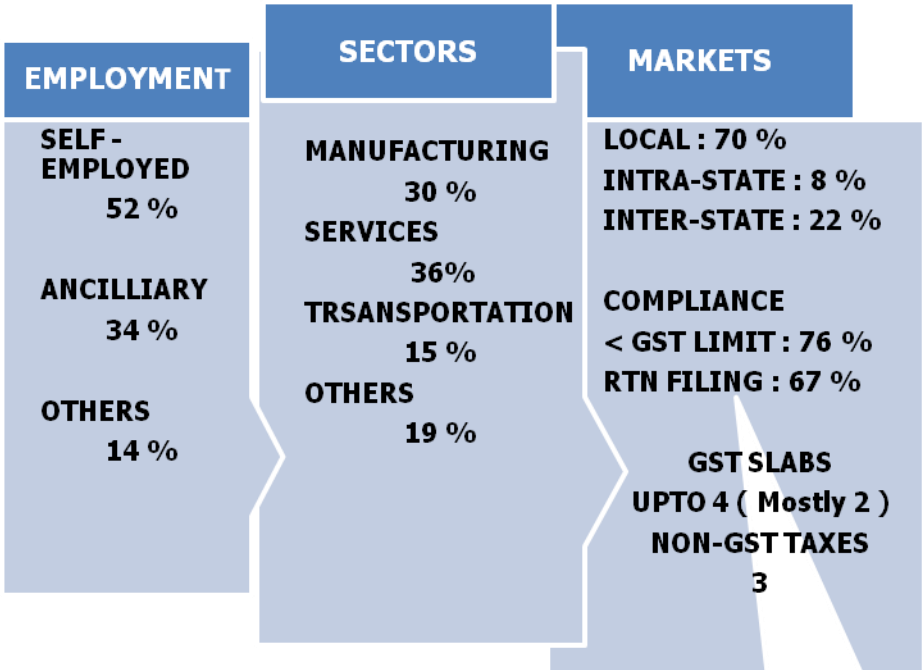
SUMMARY CHART OF GST OUTCOME

OUTCOME EXPECTATIONS	INTERNATIONAL EXP	INDIAN EXP
Administrative Impact		
Awareness programs critical to its success	Absolutely essential for success	No/inadequate awareness programs
Speedy claims settlements	Data not available	Complaints of delays of over 7 months
Effective dispute resolution	Not known	Still to be instituted. Being debated
Robust IT infrastructure with high uptime	Critical & functioning	System crashes and constant changing
Economic impact		
Elimination of Corruption/ shadow economy	Difficult. Even Germany has 15% Shadow Economy	Govt reports 400Cr evasion for 100 cos
Employment Generation	Roughly 20 mn jobs created	Employment generation negative
Increase in GDP	2% increase	GDP decline
Reduction of profiteering & false declarations	Unable to implement effectively	Compliance ratio already low& anti profiteering provisions ambiguous.
Policy impact		
Does not lead to inflation	Data not known	Too early to predict
Established RNR (REVENUE NEUTRAL RATE) definition in place	Most countries have RNR as Standard Rates	Indian RNR is very high
Exemptions not to benefit the rich	It has benefitted the rich.	Significant exemptions –benefit the rich
Funds not blocked	Data not known	Blocked & impacted Working capital
Increase in efficiency of distribution	Not known	Not known
Increase in efficiency of manufacturing	Not studied	Not studied. Un-organized sector declined
Increase of exports	not studied	Exporters have been struggling for reimbursements.
Litigations & harassment reduction	Not studied	Somewhat eased but still too early
Microbusiness is favorably impacted	Favorably impacted	Negatively impacted
Prevent tax wars between states	Partly – face problems	GST Council effective for prevention but first signs of State Centre disputes visible.
States are revenue neutral	Revenue neutrality achieved	Attempt has been made to achieve this. Too early to assess definitively.
Traceability of transactions	Not known	Possible only if totally automated
Tax impact		
Increased tax compliance	Tax compliance increased	Tax compliance dropped
Widening of Tax base	Witnessed Increase of 30%	Early Days yet
Net Impact of taxes	Reduced from before GST	Reduced from before GST.

Gurgaon provides a good site for such a study as it has a large number of small and micro industries, as well as a large service sector. Selection of this segment was based on the premise that unlike organized enterprises, micro, small and unorganized sectors neither had the resources nor the trade and industry bodies to manage the transition to GST regime. Also, this is the sector that according to many reports has suffered from a badly framed and poorly implemented policy: their experiences would be the acid test for evaluating the GST launch.

A survey was undertaken in early 2018 in the Gurgaon region in partnership with *Molitics* who carried out field interviews by 12 enumerators stretched over 60 days in which 1,000 respondents (766 Serious & 234 Superfluous in responses) from micro/small industries/ traders / service providers were selected on a random basis. The questionnaire consisting of 20 questions with multiple choice answers attempted to gather three types of information from respondents: the nature of their industry/service and number of slabs applicable, second the impact of GST and third, the kind of government guidance and help available to carry out the filing process.[1]

AIPC GURGAON: GST SURVEY: RESPONDENTS- PROFILE
FIGURE 2: SAMPLE SIZE: 1000 ; MEANINGFUL RESPONDENTS : 766



As fig 2 above shows, 52% of respondents were Self Employed & 34% consisted of ancillary. Sectorally, 30% were in Manufacturing , 36 % in Services , & 15 % in Transport ; 76% of Industries were below the GST threshold while 67% filed GST returns. While most of their dealings were local, 22% of interstate dealing took place probably due to the fact that Gurgaon is close to 4 other states. Average turnoverwas in the region of Rs 30,00,000 just over the GST limit. The source of most of their input materials was within the state and attracted a maximum of not more than two GST slabs.

1 : QUESTIONNAIRE : broadly covered (1) Background of Person Interviewed & his / her Sectoral Profile , (2) Turnover / GST Registration status , (3) Number of GST Slabs applicable , (4) Impact of GST on Business in terms of Volume / Profitability / Cash Flows / Compliance Costs / & Credibility with Customers (5) Impact of GST on Curbing Corruption , Price , Elimination of Multiple Taxes & Cascading Taxation , (6) Convenience or otherwise of Local / Intra State / & Interstate transactions (Being n close vicinity of States of Rajasthan , Punjab , Delhi , & UP, Inter-State transactions were of relevance) , (7) Nature & Efficacy of Help Guidance , Training , & Free Consultations made available by Government or its designated Agencies , & (8) Cost of requisitioning External Consultants / Chartered Accountants to ensure compliance

5

Major Findings of the Survey

Before presenting our findings, some major challenges faced by the survey need to be pointed out. The biggest challenge was the inability to get enough data to differentiate the impact of GST from the effects of demonetization. No survey was conducted in the area during the period of demonetization apart from some private surveys, which showed a severe decline of 60% - 80% of the informal sector and increase in unemployment. The impact of demonization, from reports by economists and the media, was disastrous especially for this segment of small industry and service sector. Shrinking markets, financial constraints, lack of customer base and liquidity had been experienced well before GST, forcing many small industries to close shop. Also, sudden introduction of GST without adequate preparation, awareness programs or training caused further hardships for the respondents.

The second challenge was that the survey undertaken barely 9-10 months after implementation of GST was too early to come to any firm conclusions. International experience indicates that it takes at least 24 months for GST to be successfully implemented and that too after there has been extensive training, consultation and awareness programs undertaken with all stakeholders. Moreover, the views of the respondents are not backed by adequate hands-on experience of the GST filing process as this is done by their Chartered Accountant. The undue hurry by the government to take credit for the implementation of GST, and use of policy shortcuts, is visible in full measure in some of the negative feedback from the survey. *Thus we argue this survey provides an alert for reviewing the implementation approach and programs. It must be viewed only as an indicator of the mood of the respondents and pointers for making midstream corrections.*

Impact of GST:

There was near unanimity amongst all the respondents that GST had has an adverse impact on their business, leading to unhappiness with the policy. The most important impact reported has been slowing of business, which has contributed to loss of income to the business person and to the national economy. A number of reasons were given by them, as depicted in Fig 3 below.

1. GST has not led to reduction in prices of goods. 75% of the respondents felt that there was no reduction either in their purchase price (many claimed they witnessed a rise) or in their sale price, but their sales had gone down significantly. 69% of the respondents confirmed that they did not gain from any reduction in their purchase prices, nor did their customers benefit from lower prices of GST. As a result, GST has created a serious chasm of distrust between the respondents & their customers who had believed that GST by reducing taxes would reduce prices .
2. GST has led to a drop in sales as figure below shows. There was a feeling that demonetization had already disrupted their business due to lack of money with people to purchase their products. The unorganized sector lost a large chunk of customers – the migrant classes, who lost their jobs and found the products too high priced. All this *dropped sales* revenues for the respondents. 76% of the businesses of our respondents have experienced sales down after the implementation of GST as shown in Figure 3.
3. GST has actually put an additional cost burden on businesses (fig 3) at a time when they are experiencing serious survival issues. Over 82% of the respondents pointed out that it was because of additional costs they were incurring due to the need to hire Chartered Accountants since they were not familiar with the new accounting procedures and gave their raw traditional data to the Chartered Accountant who calculated the GST to be paid & reported
4. 81% of respondents pointed to serious cash flow pressure as a result of having to pay GST immediately, or within first 10 days of the months following transactions (fig 3) whereas merely 57% operated on Cash to 30 day credit, and the rest mostly on 30-90 days credit. This was in contrast to their understanding that GST would simplify procedures, subsume multiple taxes and savings would accrue from the cascading effect of the same. In the long run this could be true, as experienced internationally, but in the short run they are feeling the pressure.

5. 76% Respondents who claimed they were operating under the GST threshold find that they are still registered and compelled to file returns. This has created lack of clarity and was one of the reasons for their reluctance to answer the questionnaire. Part of the confusion could be due to Section 22 that requires people filing VAT earlier had to register for GST.
6. 74% of the respondents reported a problem in interstate transfer of goods Even Chartered Accountants do not seem to have total clarity on the GST filings, apparent from the inconsistencies in their responses.
7. Perceptions of the efficacy of GST remain mixed among respondents. On the one hand, as figure 3 shows 60% agreed that corruption has reduced, probably because they are no longer being harassed at each step of the process by multiple agencies. 55% respondents believe multiple taxes have been eliminated. But what is important is that 60% respondents believe returns have been made more complex and there is less transparency now than before.
8. Barely 25% felt the government was helpful in handholding phase. In the initial stages, it is essential for Government officers to be mentors and facilitators for the people especially in the unorganized, micro and small industries to help them understand the issues. Compliance will always increase when there is a awareness and appreciation of why something needs to be done.
9. Awareness Training by Tax Deptt appears to have been dismally low at a mere 33 %
   Over 80 % of respondents found the online filing cumbersome and had to employ Charted Accountants to do the filings. Training is the cornerstone for successful GST implementation

Fig. 3 : SURVEY RESPONSES (PERCENTAGE)

ATTRIBUTES SURVEYED	YES	NO	NOT KNOWN
SALES DOWN	76 %	22 %	2 %
INCREASSED OPEX : C/A NEEDED	82 %	18 %	
CASH FLOW PROBLEMS **	81 %	19 %	
PROBLEMS IN INTER STATE TRADE	74%	26 %	
HAS CORRUPTION GONE DOWN	60 %	40 %	
GREATER TRANSPARENCY	19 %	60 %	21 %
GOVERNMENT HELP & ADVICE	25 %	75 %	
AWARENESS TRG. BY TAX DEPT.	33 %	63 %	04 %
MULTIPLE TAXES ELIMINATED	55 %	45 %	

**** CREDIT EXTENDED BY RESPONDENTS**

- ✓ **Average 30 Days : 57 %**
- ✓ **30-90 Days : 30 %**
- ✓ **> 90 Days : 13 %**

QUOTE: *"Design of GST in India FAULTY ---- Technical glitches & procedural problems ----- Portal DELAYS in Refund Payments ----- Scale of CONFUSIONS ----unacceptable for individuals & Businesses"* ***UNQUOTE***

(Head of Ministerial Group on GST in an interview to OUTLOOK MONEY's Special Issue on GST at GST's first anniversary in July 2018)

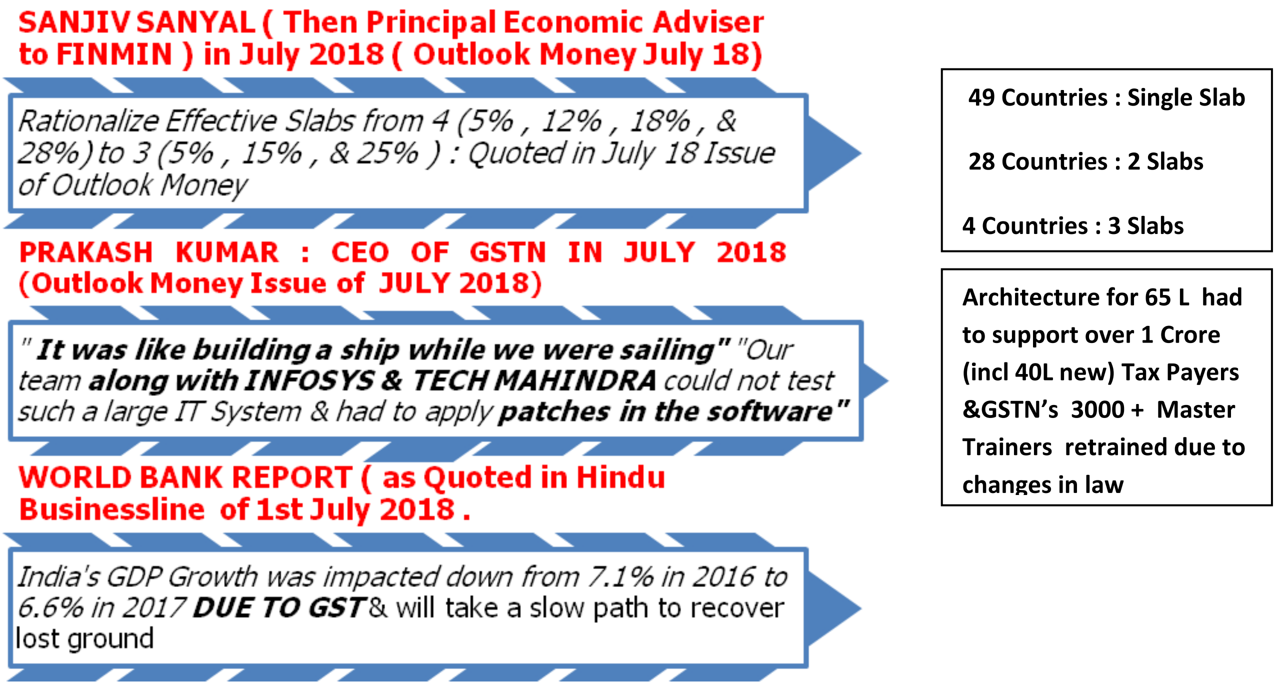
PART 2

A REVIEW OF THE PAST 30 MONTHS(July 2017-Dec 2019)

Given the high velocity of changes , clarifications , admissions , denials , claims , counter-claims , and a general sense of inadequacy & confusion since GST launch on 1st July 2017 , the Ideation Group chose not to publish the Survey Results earlier, lest they became superfluous & overtaken by events . However, with 30 months of the GST regime as on 31st December 2019, a Desk Research, which had already been initiated in August 2018, was updated and the findings are documented in Part 2 of this Report to present a balanced & non-partisan overview of the state of play in what promises to be a long running saga of GST in India. Unorganized Sector in Gurgaon is , in this part , no longer the Primary Focus , though remains an important part of the Fact Check attempted here .

A good way to carry out such a review is to start with the **"3W"**namely **W**hat**W**ent **W**rong, as summarized below in Fig 4

Fig. 4: VOICES THAT MATTER



***" SOFTWARE SYSTEMS HAVE TO BE in tune with the law , & not vice versa"* ruled the Honb'le Delhi High Court (the Hindu 23rd December 2019) , adding that not putting a workable system in place before implementing GST & not fixing the glitches despite passage of over 2 years reflects poorly on --- concern for troubles faced by Businesses throughout the country**

As fig 4 contents reveal very effectively, the launch of GST appears to have been ill-planned & hastily introduced . Despite a 17-year gestation & ample opportunity for better pre-launch planning, the frequent post launch "solutions" neutralized & perhaps even negated some of the benefits that should have accrued to the Nation through GST. ***Indeed, it is noteworthy that post launch clarifications issued during the first 12-months (July 2017 to June 2018) were as high as 304, thus exceeding an average of 1 clarification per working day .*** There were some rather disruptive contradictions in the demi official clarifications from then Interim FM & the final one from the GST Council.

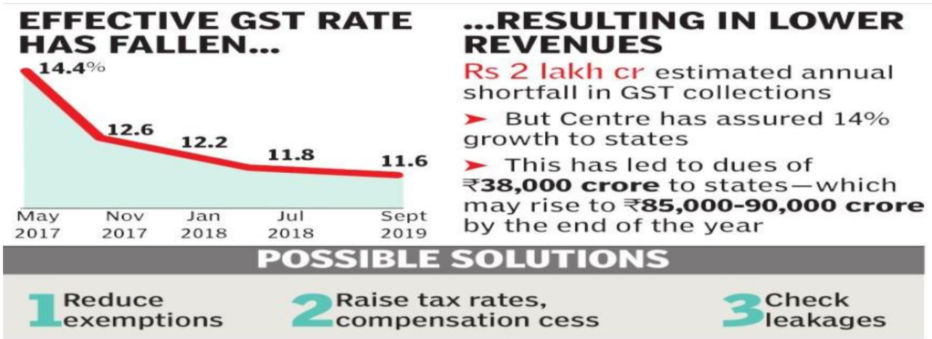
A "LOCAL CIRCLES" Survey carried out in July 2018 with over 8000 respondents,though, like any other survey, not empirical but dependably indicative, revealed the following disturbing scenario post GST:

- MONTHLY GROCERY BILL : Up 63% ; Down 21 % ; N/K 16 %
- COST OF EATING OUT : Up 57 % , Down 28 % , N/K 15 %
- INPUT CREDIT PASSED ON TO YOU : Yes 15 % ; No 61 % ; N/K 24 %

Sounds familiar: does it not!!

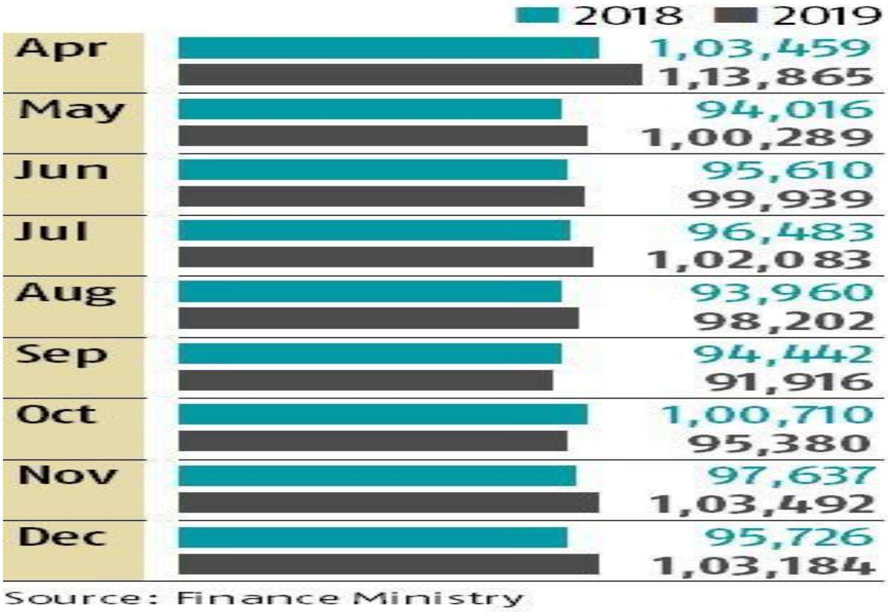
<u>BREAKING WITH TRADITION</u> :

It is noteworthy that the large number of course-corrections adopted by the GST Council , headed by the Union Finance Minister with Finance Ministers of all States represented , had hitherto been entirely through consensus. While speaking at the Business-line Change-makers function in mid-March 2019 , late Shri Arun Jaitley, then Hon'ble Union Finance Minister , had stated ***"Sometimes States Yield , sometimes I do"*** , thus ascribing the role & road map for the GST Council , also adding that ***"Nothing should be voted upon in GST Council"*** in deference to the Council being a symbol of Federalism in true form. All this changed at the 38th Council Meeting in mid-December2019, after an impressive consensus based track record of 37 meetings. ***" Tradition is not part of the Rule Book"*** was the response from Smt. Nirmala Sitharaman, the incumbent Honb'le Union Finance Minister , when asked why she had asked for & won a majoritarian vote at the Council Meeting , in a break from the healthy tradition established hitherto. An obvious sign that unlike her predecessor , known and respected for his openness to convince or be convinced through dialogue at GST Council meetings , the age of majority wins has crept into the GST Council , preceded by some friction , now augmented to acrimony between some States & the Union Finance Ministry . Some of this acrimony may probably be due to what is depicted in Fig 5 below (sourced from the Net: Originator Unknown)



"The effective indirect tax rate on many products in the pre-GST era was around 25%, which has reduced to 18% in GST. In the absence of a significant increase in volumes, there would be an impact on revenues," said M S Mani, a partner at consulting firm Deloitte India.
(As published in Times of India of 3rd January 2020)

Fig. 6 : APRIL / DECEMBER MoM GST Collections for 2018 & 2019



Indeed November & December 2019 figures are impressive but baffling in the perspective of the Economic slowdown so visible.

Fig. 7: Total GST Collections upto December, 2019 (Rs. in crores)

Month	2017-18	2018-19	2019-20	
April	–	1,03,459	1,13,865	
May	–	94,016	1,00,289	
June	–	95,610	99,939	
July	21,572	96,483	102083	
August	95,633	93,960	98202	
September	94,064	94,442	91916	
October	93,333	1,00,710	95380	
November	83,780	97,637	103492	
December	84,314	94,726	103184**	
January	89,825	1,02,503	–	
February	85,962	97,247	–	
March	92,167	1,06,577	–	
Total	7,40,650	11,77,369	908350	Originally Targeted
Average	89,885	98,114	100927	110,000

**** In RsCrores : CGST 19,962 ; SGST 26,792 ; IGST 48,099 ; CESS 8,331**

Source TAX GURU 2[nd] Jan 2020

As can be seen, the growth, YoY, in Average GST collection per month has been 9.15% in FY 2018-19 & 2.86% in FY 2019-20 till 31sr December 2019 : both far short of the 14% growth Y-o-Y that had formed the underlying principles of the GST launch originally , with a monthly target of Rs 110,000 Crores . Whilst the original registered GST businesses were estimated at 65 Lakh (55 Lakh on migration from old regimes of ED / VAT / ST) & 10 Lakh new registrations initially , the registrations have reportedly exceeded 120 Lakh (after weeding out over 10 Lakh fraudulent ones) without corresponding upgrades to the IT architecture supporting this edifice, with mandated Return Filing compliance improving from the dismal 57% in the first 18 months , to over 80% during the following 14 months ended 31st December 2019 (for transactions till 30th November 2019). 81.2 Lakh Returns for November 2019 have been confirmed by the Finance Ministry: 67 % of total registered dealers. The 65 Lakh newly registered dealers generate a mere 12 % of total GST.

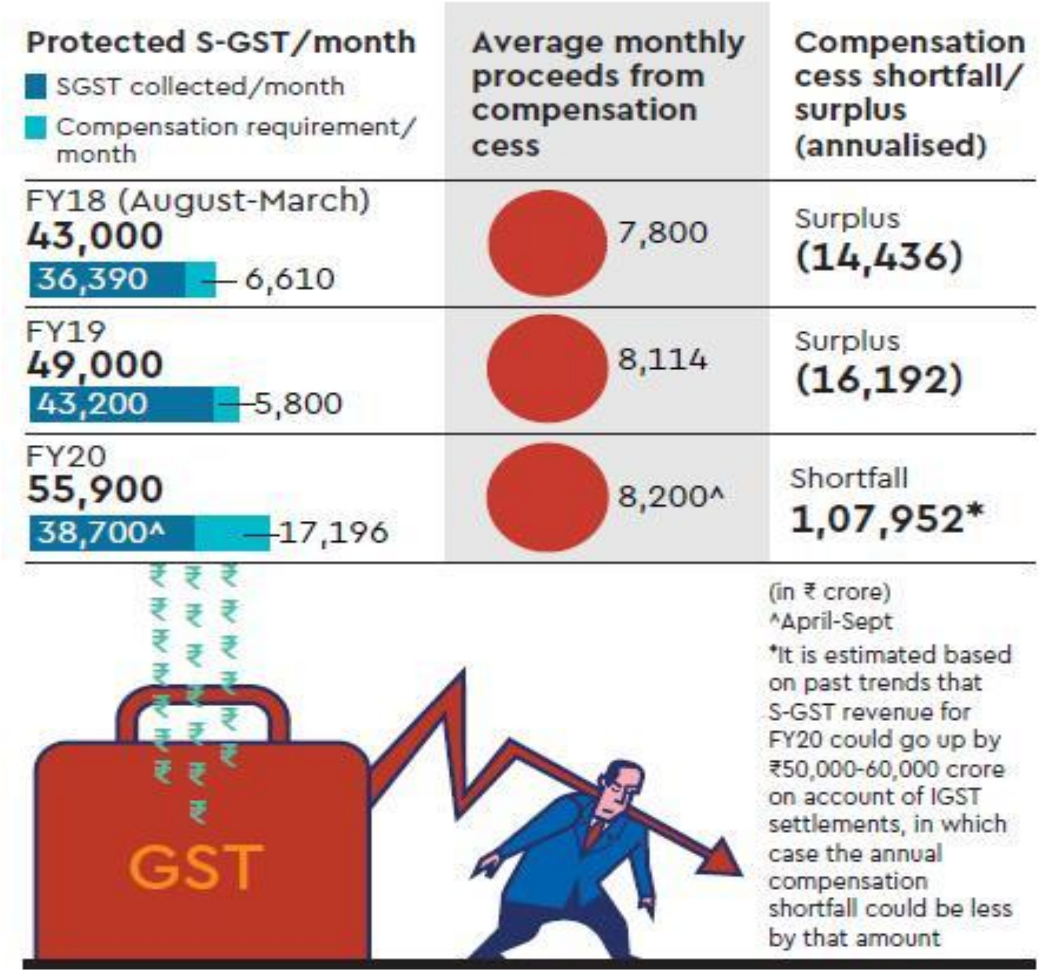
Top 10 States (Maharashtra, Karnataka, Gujarat, TN, UP, Haryana, Delhi, West Bengal, Telangana & Rajasthan in descending order account for 87.5 Lakh registrations (73% of total 120 Lakh) & generated , in the first 9 months of current fiscal (April / December 2019) Rs 57.5 Lakh Crores Monthly average GST collections (57% of Total Rs 101 Lakh per month) , an inversion of the widely used analytical tool of Pareto listing

In the overall medley of a Financial crisis looming large on the horizon, ahead of the upcoming Union Budget for 2020-21, the issue of a foreseeable shortfall in GST Compensation Cess with reference to Revenue Neutrality for States warrants a serious look , in as much as it has a direct impact potentially on the Federal structure underlying the GST regime & on Consumer prices, Inflation , & a fresh bout of fiscal shock to the unorganized sector .

The states are constitutionally guaranteed a 14% YoY growth in GST revenue over the FY16 base, which means that the combined average monthly GST revenue of all states must be Rs. 55,900 crore this fiscal. The sharp decline in Goods and Services Tax (GST) collections could not only add to the Centre's fiscal woes, but also deprive state governments of their assured compensation for revenue shortfall.

Fig 8 below reflects the Centre / States / Compensation Cess dynamic in as pragmatic a manner as can be attempted CESS. Constitutionally, is a specific levy aimed at funding a particular sector .Compensation Cess levied on some Goods & Services in the 28% GST slab , are intended to be used under a Guarantee Mechanism wherein States & Union Territories with Assemblies are to be compensated for five years till 30th June 2022 , if the GST Revenue Growth is less than 14% YoY. The amount is disbursed to qualifying States bi-monthly & the Union Government defaulted in two such instalments in Q3 of current fiscal, after having disbursed Rs 65,250 Crores for the first 6 months thus leading to first signa of friction in the GST Council. .The first default (Sept 2019) of Rs 35,298 Crores was released recently, leaving an overdue tranche for November 2019. Going by mainstream Financial Media Reports , the gap between required funds from the Compensation pool & collections into it could rise to over Rs 63,000 Crores at the end of current fiscal even after IGST Revenue neutralising a large chunk of present shortfall at the end of the FY. Finance Ministry is reportedly evaluating a sensitivity matrix of projected GST growth until June 2022 to arrive at either a truncated Compensation Model and / or an enhancement in Compensation CESS generation. The reported accumulation of over Rs 3 Lakh Crores in the Consolidated Fund of India (CFI) including , for example , Rs 94000 Crores of Secondary & Higher Education Cess .is reportedly unlikely to be utilised to extend funding , even as a loan, a GST Compensation deficit..

Fig. 8 : Source FE 3rd January 2020



*"**In the 150th Year of Gandhi ji, his Talisman "Last Person First" is the need of the hour** " ----- Prof Arun Kumar : Author :"**G**round **S**corching **T**ax" in the HINDU Centre-page recently*

DICHOTOMIES PREVAIL

Even 36 months after its implementation, dichotomies prevail and some are illustratively outlined below:

- A Machine manufacturer makes a supply to a project in a Government approved project of national importance, & the transaction normally in the 18% IGST slab is allowed at a concessional rate of 5% IGST. If the supplier also provides a chargeable service for installation & commissioning, his Service invoice attracts IGST @ 12% .If his customer levies a dissatisfaction penalty, the penalty attracts IGST @ 18%. What if he subsumes his Service cost & a contingent penalty into his basic price for the Machine, chargeable @ concessional IGST of 5%.
- Hotel Room tariff charged at Transaction rate which, after discounts, could fall below the designated threshold for Luxury Hotels and thus attract 18% GST. Food & Beverage expenses charged to the room however continue to attract the Luxury slab of 28% If Room Tariff includes complimentary breakfast , as is mostly the case , a part of the tariff could get charged @18% and notionally apportioned part at 28% ?
- Inverted Duty Structure Refunds of over Rs 28000 Crore filed by over 27,000 entities between GST launch & now have come into focus & the GST Data Analytics wing tasked to scrutinise all past & current refund claims after discovering a fraud of over Rs 1,000 Crore. The trigger reported in media as the Hawaii Chappal fraud entailed creation of several shell entities by Hawaii Chappal manufacturers to take advantage of the Inverted Duty structure in GST. Raw material for chappals (EVA compound) attracts 18% IGST whereas sale of these Chappals are in the 5% IGST slab. The surplus of GST paid on RM at 18% and GST payable on Sales at 5% is lawfully permitted as a cash refund under inverted duty structure. Tip of the iceberg?
- GST on Educational Books is Nil in physical form, 12% on E Books ,& 18% on International Standards bought on-line .Availability of Engineering Standards in physical form is often a challenge.
- Under the **GST** law, the input tax credit of purchased services and goods will be available only when the inward supply details filed in buyer's GSTR-2 return **matches** the outward supplies details filed in supplier's GSTR-1. In a further jolt to cash strapped businesses, GST amendments of December 2019 in this regard may deny up to 90% of legitimate Input Tax Credits to businesses facing a mismatch with their vendor’s defective returns or non-filed returns.
- Several other facets remain divorced from reality, such as Reverse Charge Mechanism, Anti Profiteering provisions,& inclusion of sectors not brought under GST regime so far, such as Oil &Gas , Aviation Fuel , Diesel & Petrol.

CONCLUSION & RECOMMENDATIONS

In conclusion, the informal, micro, small industries and traders are unhappy with GST as their very existence is under threat, costs of doing business have increased, there has been no reduction in prices and if anything, the economy & their businesses have shrunk. For this segment, there is a need for making these sectors competitive.

There is a delicate balance that needs to be maintained in designing GST between the need for widening the tax base and roping in more people to share taxes on the one hand and making them unprofitable on the other hand. For long, taxation has been a major tool for channeling the country's resources into a particular direction. Maintaining the flexibility is extremely critical to any country. Keeping the above in mind, there is a need to revisit some important issues especially concerning the informal and the small sectors.

India presents a unique challenge in that a large chunk of the State revenues come from Indirect taxes mostly from the small and service sectors that operate in the State. Moreover, States also need a little space for policy making. Given that it has been a herculean task for the States to meet even their essential requirements, protecting revenues for the Union Governments has been at the center of the GST Policy making. Collection of actual data from 16 states demonstrates that States revenues accounted for nearly 78.5% of all states VAT as of 2016, 85% of the VAT Dealers and 92% of the service tax registrants had turnovers of less than Rs. 1.5 Crores.

70% of the taxpayers having revenues under Rs. 20,00,000/- barely pay Rs 3,600 crores. The cost of collections is likely to be more than this.. In Karnataka, 60% of the taxpayers are having less than Rs 20 lakhs revenue &account for less than 1% of the tax revenue. So, wisely, the GST threshold was kept at Rs 20,00,000 below which they are out of the tax net.
Services are an important sector that accounts for 56% of the GDP. Taxpayers having revenues of less than Rs25 lakhs pay 23% of the service tax. Therefore, there is a judicious balance that has been worked out in the GST.

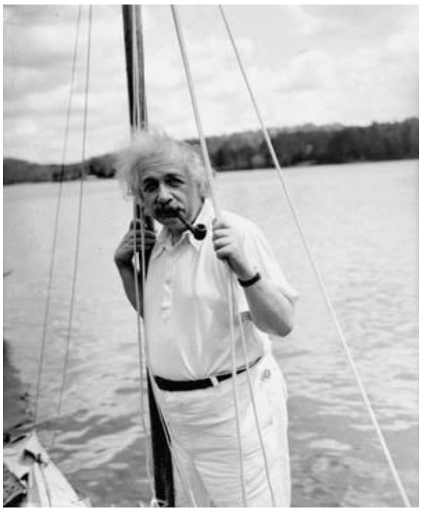
CAN UNORGANISED SECTOR WITHSTAND THE MIGHT OF THE ORGANISED SECTOR?

Survival of the unorganized sector is at stake for a number of reasons. Much depends on which sectors the organized sector chooses to enter and flex its muscles based on their inherent advantages of economies of scale, branding, financial & human resource strengths, capability to raise funds at attractive terms etc. The only differentiator for the unorganized, micro & small industries was the price and that too mostly due to avoidance of taxes. This is not a blow, GST has burdened additional costs of recruiting Chartered Accountants, investment into computers etc. on the unorganized/micro/small industries to comply. While there are no parameters to measure the impact of this balance, it would be fair to assume that a number of unorganized sector businesses will close shop & will have a negative impact on GDP & increase unemployment.

This argument is reinforced by the declining business in Textiles and their exports and the entry of large companies into the porcelain business. There are a number of issues that arise for the Political parties to ponder and create an ecosystem that will enable the unorganized sector to flourish. Some of the possible methods of preventing the negative effects are as follows:

1. Reservation of certain sectors for Micro, Small & Unorganised enterprises, disallowing the entry of large organized sector enterprises. Like in the past, their areas of operations must be protected and reserved for them.
2. That in itself is not enough. There is a need to subsidize this sector, to the extent of their GST, to have the competitive edge against the organized sector. For example, it could provide loans at 1% above the Bank savings rate. Banks have access to public money at 3-4% interest only from savings account holders. These funds can be used.

3. Unorganized sector must be assisted in marketing efforts by making it compulsory for the organized sector to purchase 10% of their turnover from the unorganized sector. This will establish a win–win bond. Large companies could provide marketing, quality control, capital & managerial assistance and benefit in return from the low cost of production. Government needs to device mechanisms to discount unfair and predatory pricing
4. For GST to be successful the Government needs to provide Internet connectivity and 'input devices' free of cost for the unorganized sector to be able to input their GST requirements. The government must provide a 'plugin' software that can enable their customize their raw simple data to fill the prescribed & mandated GST formats.
5. A ROBUST GST NETWORK AND SOFTWARE PROVIDED TO THE UNORGANISED, MICRO, SMALL & TRADING COMMUNITY IS INDEED THE NEED OF THE HOUR.Nearly 85% of the VAT dealers and 92% of the Service tax registrants earn less than Rs 1.5 Crores and are mostly in the states. Of the 3 crores small businesses that have incomes above the threshold limit of Rs. 20 lakhs, over 60% have not computerized themselves. For them to be held responsible for accurately participating in this highly automated effort without proper facilities and training is, to say the least, a challenging task. Moreover, there is no guarantee of uptime due to frequent power failures etc.
6. GST Network relies heavily on its two data centers in Delhi and Bangalore and the program is vulnerable to failure. We have already witnessed the setback to the program due to system shutdown on the first day of IGST introduction. There is a need, as a minimum, for a nationwide network of over 30 computers (one in every state and UT as a minimum) with redundancy built in. This network should have user-friendly software (centrally updated by GSTN) that can be accessed by the taxpayers free of cost. The government has to ensure high uptime even in the customer premises. In addition, the Government will need to provide an input terminal at each of the organization esp. in the unorganized, micro and small companies free of cost so that they have access to the system for uploading. Unless this minimum infrastructure is provided, it would be unfair for the government to expect compliance. Small industries do not have the capital to invest into the latest hardware and software required for them to file returns. Failing this, apart from not getting compliance, the sheer agony of the experience will turn off the stakeholder and will frustrate the GST effort.
7. GOVERNMENT NEEDS TO UNDERTAKE A MASSIVE AWARENESS AND TRAINING PROGRAM FOR THE UNORGANISED SECTOR. Most of the perceptions are mainly due to the lack of understanding of the issues and processes involved in GST. This segment of industry is presently vulnerable to the CAs. The Government must partner with NGOs and activists to undertake massive training and awareness programs to ensure that this segment understands the issues in a simplified manner. International experience clearly demonstrates the ill effects of lack of support from the stakeholders.



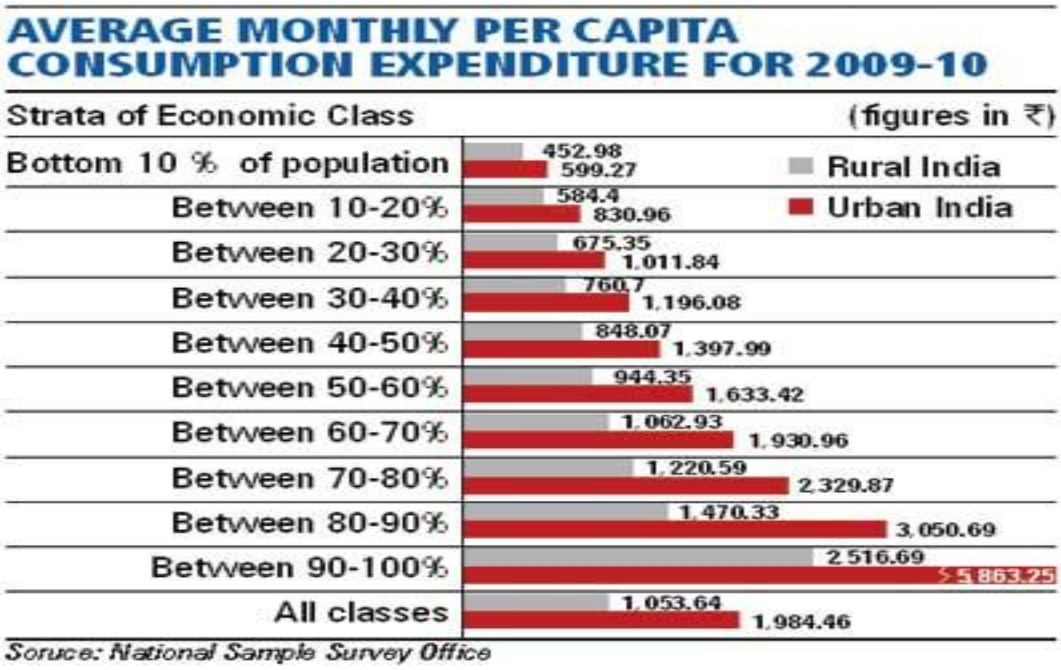
HON'BLE PRIME MINISTER MODI QUOTED ALBERT EINSTEIN DURING HIS SPEECH AT THE MIDNIGHT LAUNCH OF GOODS AND SERVICES TAX. MR.MODI SAID: "EINSTEIN SAID IF THERE IS SOMETHING IN THIS WORLD THAT IS DIFFICULT TO UNDERSTAND, IT IS INCOME TAX. I WONDER WHAT HE WOULD HAVE SAID ON SEEING OUR MULTIPLE TAX."

THOUGH NOT DIRECTLY CONNECTED TO THE INFORMAL AND SMALL SECTOR, IT IS MOST APPROPRIATE HERE TO BROADEN THE RECOMMENDATIONS ON A FEW MORE ISSUES THAT DESERVE TO BE REVISITED. (Though Data cited below is of mid last decade vintage, it reflects the segmentations as truly applicable today as it was then)

REVISITING EXEMPTION:

The international experiences have empirically demonstrated that exemptions are detrimental to the poor and favour the rich and hence should be avoided. The argument for providing exemptions is that it will burden the poor by having to pay an additional tax while he is struggling to eke out a living. Thus, 54% of the CPI items have been exempted in GST. According to the Business Standard of Jan, 2013, the urban households spend 84% more than their rural counterparts. According to the NSSO survey (Fig 9 below) , the top 10% rich Indians spend Rs 29,986 per capita on food items and Rs 36,264 on essential items. Thus the top 10% rich, approximately around 130 million people spend roughly Rs 66,250 per capita on essentials. This means even if these top 10% people were to pay a nominal 15% GST on essentials,it could add nearly Rs 10,000 Crores from the Rich &recoup the revenues foregone by t he Government, with the best of intentions. Moreover, according to 2009-10 survey, the per capita consumption of the top 10% is ten times that of the bottom poor. So, there is need for reflecting on whether it is wise for the wide spread populist approach of exempting the items.

Fig. 9



Among the rich 10%, 46% are salaried class and 31% are self-employed. There is a case to be made that their direct taxes be raised appropriately for reclaiming the concessions gained by them in the GST. The excess mopped up should be put into subsidizing the farmers and making them profitable. This has the advantage of stimulating the economy by putting purchase capacity in the hands of the farmers and stimulates the multiplier effect

REVISITING EXEMPTION ON EDUCATION, HEALTH & POWER:

In the case of education, the current tax structure turns out also to be regressive, with the bottom 4 deciles effectively paying greater taxes than the top 6 deciles. Since most of this is consumed by the rich and that too going in private institutions, it is worth reconsidering exemptions. In the health sector, the bottom 40% end up paying higher taxes as bulk of the expenditure is on medicines. One can work on similar exercise as above to find that considerable incomes can be generated for the government by increasing the rate of taxation and using these to compensate by building and operating public schools, hospitals etc. Similiarly nearly 60% of the electricity is consumed by the top rich segment, exempting electricity forces the poor to pay more than the rich and benefits the rich.

REVISITING A NOMINAL 2% GST ON GOLD:

The Government has justified a low GST on gold so as not to burden the common man for buying a 'mangalasutra'. The other argument is that if the taxes are increased it will encourage smuggling. This is true for many other products. If one analyses the Gold consumption in India, one will find that 7 states account for 36% of the urban population and 29% of the rural population. Again in the case of Gold, the GST favours the rich using gold to convert their black money. If the Government is really interested in protecting the mangalasutra of the poor, they can compensate the GST charged for the poor to the seller either thru a coupon or against Aadhar card or other proof. The rich will still enrich the government by over Rs 8000 Crores. Therefore, there is a strong case to be made for revisiting the GST for Gold.