Gaming GST

Businesses across the country are indulging in large GST violations. No wonder there is a huge shortfall in collections

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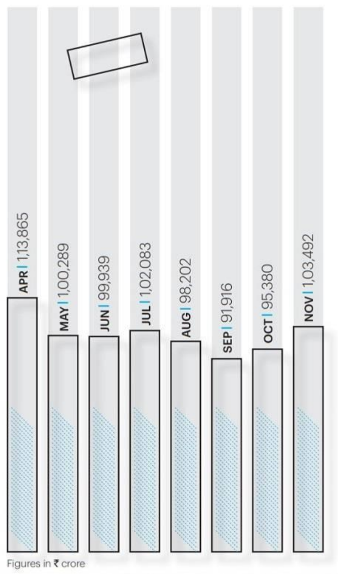
Illustration by Raj Verma

Ranchi-headquartered 'Baba Rice' is a household name in the eastern part of India. Even though it's not a premium Basmati brand, an average consumer in Jharkhand or adjoining Odisha would prefer it to national brands such as Daawat or India Gate as is evident from the 70 per cent marketshare Baba Rice enjoys in the region. Yet, parent Baba Agro Foods recently rolled out the same rice under another brand 'Ranchi Gold'. Intriguingly, while Baba Rice is priced at Rs 2,640 per quintal, Ranchi Gold is just under, at Rs 2,610. Why? Baba Agro Foods Chairman Yogesh Kumar Sahu says the marketshare of Baba Rice has eroded 10 per cent since the arrival of GST in July 2017. Ranchi Gold was his desperate defence mechanism.

'Baby Doll', 'Babuji', 'Apple' and even 'Kakaji' are just a few rival brands that mushroomed and undersold Baba Rice by circumventing GST. While branded commodities such as rice, atta and dal are subject to 5 per cent GST (commodities in the pre-GST era did not attract tax), white label products can escape GST.

Flip the packs of any of these brands, and they carry a disclaimer: "We hereby voluntarily forego... all types of actionable claim or enforceable right in respect of brand name printed on this bag." According to GST norms, unbranded commodities need to package their products in white packs and mention the company's name along with the FSSAI number at the rear of the pack. "This is a grey area which most companies are capitalising on. Nowhere in the law is it mentioned that it is illegal to pack in a branded pack with a disclaimer," explains Sahu. Since these brands don't pay GST, they are cheaper than branded commodities. Ranchi Gold exploits this loophole. Sahu claims there has been an uptick in volumes since Ranchi Gold was launched in September. "I have covered up some of the lost ground, but I still have more to do," he adds.



MONTHLY GST COLLECTIONS HAVE BEEN BELOW ₹1 LAKH CRORE IN 20 OF 28 MONTHS SINCE LAUNCH

As expected, branded commodities have taken a hit. Krishnamohan Kumar, a wholesaler of foodgrains in Durgapur, West Bengal, confirms that there has been a 60 per cent dip in sales of branded commodities: "Even established brands such as Daawat have come up with non-GST options." Hemant Malik, CEO, ITC Foods, maker of Ashirvaad Atta, had expressed concern in an earlier interview with BT over the entry of a huge number of local brands that were biting into Ashirvaad's market share by ducking GST.

Since GST's launch, the government has been playing a painful waiting game, hoping for a jump in collections to shore up indirect tax revenues. However, flagging collections have dashed all hopes of higher revenues from capitalising on digitisation and formalisation via GST.

Flagging GST collections means lower Central revenues and even higher fiscal deficit. Not to mention that the tussle with states will intensify. Collections averaged Rs 82,294 crore per month in 2017/18, Rs 98,114 crore per month in 2018/19 and Rs 100,646 crore per month so far this fiscal against a target of about Rs 1.1 lakh crore per month. India is likely to end fiscal 2019/20 with an overall GST shortfall in excess of Rs 1 lakh crore. The GST Council has to look no further than segments such as these for answers to why India's GST collections have failed to take off.

Not only have traders and businesses found ways to circumvent the tax, 'cash-only' value chains operating without invoices have managed to stay out of the GST network from end to end. Under-invoicing is rampant, and unregistered dealers have avoided GST calling it too complex. Some companies are exploiting layers of subsidiaries to fool the law.

Unregistered Dealers

Walk into a neighbourhood store in Indore, Varanasi, Udaipur or any non-metro city and town and ask the store owner about GST compliance. The immediate response would be in the affirmative. Probe a bit, however, and the owner would invariably say he is an unregistered dealer, which means that he earns less than Rs 40 lakh a year, and so does not need to register with GSTN. But distributors of large FMCG companies whisper that these neighbourhood stores earn much more than Rs 40 lakh a year, but don't want to declare their income in order to circumvent GST. Anuj Agarwal, owner of a kirana store on the outskirts of Indore, is brave enough to admit that he avoids GST. "It's too confusing and expensive. I don't know how to claim input credit, so I might as well not declare my income." Agarwal largely sells unbranded commodities such as rice, atta, sugar and dal, for which he doesn't need to have a GST number. His store also has everything from biscuits and snacks to floor cleaners and detergents, but most of them are local brands. "These brands themselves don't pay GST, so, I am safe," he smiles.

Manu Misra, a wholesaler of leading FMCG brands in Varanasi, says that post-GST, sales of large brands have nosedived and his business has gone down by 30 per cent. "Smaller retailers prefer selling local brands so that they dont have to pay GST. Moreover, local brands are cheaper and offer more quantity." Misra adds that he too has started buying non-GST brands to bridge the gap due to the fall in sales of bigger national brands.

This explains why HUL Chairman Sanjiv Mehta said in one of the quarterly result meetings that consumption in the rural markets has reduced drastically. Apart from lower spending power due to slowdown, GST has also had a negative impact on branded consumption.

Fake Entities

Many businesses are using layers of subsidiaries to evade GST. Vadodara-headquartered Manpasand Beverages has allegedly conducted sale and purchase of its products across 30 'fake' entities and indulged in a Rs 40 crore fraud. Real purchase and sale transactions were shown with values getting inflated with each transaction in order to claim a cumulatively larger amount of input tax credit. The company was already in the eye of a controversy as its audit partner, Deloitte, had resigned stating Manpasand was not being transparent about its business. The GST fraud led to the arrest of the MD and CFO of the company.

A grain wholesaler (speaking on condition of anonymity) in Hisar, Haryana, with a monthly turnover of Rs 1.5 crore, has three entities and all of them report a turnover of less than Rs 40 lakh per year and hence don't come under the GST ambit. "I had to do it because I can't afford to hire chartered accounts and invest in e-filing systems. My cost would have gone up by Rs 25 lakh per year and my margins would remain the same," he says.

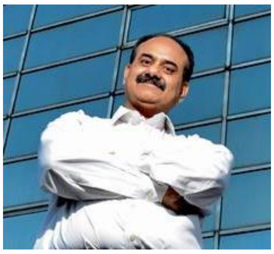
A partner of a leading consulting firm explains a more blatant way of using multiple layers of subsidiaries to evade tax. "Say, a business has six group companies. Each sells to the other company. The company with the highest sales closes down and vanishes. It files a winding up petition, which costs just Rs 12,000. If the tax department comes knocking at its doors, the promoter asks the department to file its claims with the liquidator. It is a good legal safeguard for just Rs 12,000," he says.

Fake Exports

Fraudulent businesses are inventing even more innovative ways to evade GST. "Often, those who buy goods in cash do not insist on pukka bills. These bills are then sold to entities that export goods. Instead of exporting genuine goods, they export miniature or fake versions, and claim input credit," says a Delhi-based lawyer.

This September, the Ahmedabad unit of the Directorate General of GST Intelligence unearthed a scam where 'exporters' claimed Rs 400 crore input tax credit on fake bills worth more than Rs 1,000 crore. The scam involved 20 Noida-based exporters of manufactured tobacco and related goods. Since these are sin goods with tax incidence of 93-188 per cent, the scope to claim input credit increases manifold.

These exporters would source low-grade tobacco products from local markets in Delhi at the rate of Rs 150-350 a kg and export them to units based in Kandla SEZ in Gujarat by over-invoicing them at the rate of Rs 5,000-9,000 a kg. The fake bills produced by the exporters were sourced from 25 suppliers from Assam, UP, Bihar, Delhi, MP and Haryana. These suppliers are either non-existent or controlled by the exporters themselves.



Fake invoicing

With increasing incidences of fake exports invoices, the Central Board of Indirect Taxes and Customs (CBIC) had earlier this year identified exporters who were perceived to be risky on the basis of pre-defined risk parameters. The department identified over 5,000 such risky exporters in June as against about 1.42 lakh total exporters. Refunds to these risky exporters are released after verification of their input tax credit claims within a maximum of 30 days.

Rajat Mohan, Partner in chartered accountancy firm AMRG & Associates, says that in some cases input tax credit has been delayed for six months. He cites an example of an auto-spare parts manufacturer in Delhi who has not received input tax credit refund because he has been identified as a risky exporter.

Invoice Tinkering

Among the most popular ways to avoid GST is to tinker with invoices. This takes four forms: cash-only or invoice-less deals to avoid the GST network entirely; under-invoicing; over-invoicing; and fake invoices.

Crawford Market in Mumbai is a popular destination to shop for home interiors. At the time of billing, the salesmen insist that the consumer pay in cash and not ask for an invoice. Consumers agree as they then get a better deal. Generating a bill would attract GST, making the goods expensive by 5-18 per cent.

Similarly, a steel rod manufacturer confides that maximum input credit theft happens in the steel sector - via over-invoicing. Steel rods used for construction attract 18 per cent GST. "To manufacture 1,000 kg, the producer needs 1,200 kg of raw material. He over-bills to show that he used 1,400 kg of raw material and gets input credit on that," the manufacturer explains. "The biggest advantage I have is that no one can make out the quantity of raw material I have used to manufacture the rods," he says, adding that he also buys bills to use to claim input credit. "Fake bills are easily available. Over-billing is the only way I can cover up losses I make in the market. The economic slowdown has hit the real estate market badly."

In Ludhiana, India's bicycle manufacturing hub, violating GST through under-invoicing and claiming input tax credit on fake bills is rampant. Onkar Singh Pahwa, CMD, Avon Cycles, says the organised bicycle industry has shrunk by 3-5 per cent, while the unorganised sector is flourishing with a robust 15-20 per cent growth per annum. "There is a 12 per cent GST on bicycles. These people are under-invoicing heavily. If the bicycle costs Rs 2,000, they under-invoice for Rs 1,000 and are then able to offer the Rs 120 GST benefit that they get to the customer," explains Pahwa.

For price conscious consumers, savings from unbranded options is an attraction. K.B. Thakur, Secretary General, All-India Cycle Manufacturers Association, says large-scale GST violation has led to a trend of reverse FDI in India with many cycle manufacturers considering moving their manufacturing base abroad. The GST Commissionerate of Ludhiana recently raided the premises of 12 manufacturers who were ducking GST.

The next modus operandi exploits the loophole that GST Network cannot match invoices before giving input credit. As a result, unrelated invoices of different transactions are being bought at 1-2 per cent commission. For instance, by selling invoices of an item or service that attracts 18 per cent GST of, say, Rs 500 crore, one can make Rs 5-10 crore. These are invoices of different buyers, but are unrelated for the person claiming input credit. Most often, suppliers of these invoices have no businesses at all. At present, input credit is paid on a provisional basis as there is no mechanism to match invoices. The verification is possible only after both the supplier and the buyer file GSTR-3B?. The buyer of these invoices can claim input tax credits of 18 per cent or Rs 90 crore (on Rs 500 crore). This happens mostly in the B2C segment where goods are sold in the market without issuing pukka bills to customers and these bills are then sold to businesses who then claim ITC (input credit).

In the monsoon session of Parliament, Finance Minister Nirmala Sitharaman had admitted that frauds related to claiming fake input tax credit in GST have been rampant. Revenue Secretary Ajay Bhushan Pandey also admits that the quantum of GST evasion detected is significant on a month-on-month basis. "The GST Council has a crucial role (to play) in curbing evasion through various measures, including legislative and administrative, besides use of technology. Tax evasion can be effectively curbed through robust sharing of data, exchanging (information) on modus operandi, and following best practices mechanism between the Centre and state GST administrations on a regular basis through institutionalised arrangement, etc."

Around 11,456 GST fraud cases worth Rs 53,000 crore have been registered so far. In fact, claiming input tax credit against fake invoices is becoming one of the most common ways of defrauding the system. Between July 2017 and September 2019, around 5,650 cases of fraudulent input tax credit amounting to Rs 19,494 crore had been registered.

In September this year, CGST (Central Goods and Services Tax) Delhi West and CGST Delhi North in a joint operation busted a racket of invoices being issued without actual supply of goods. The masterminds had availed fraudulent input credit for seeking IGST (integrated goods and services tax) refunds for which they had created dummy companies. They had applied for IGST refunds from various ports across India and Rs 18.09 crore had indeed been credited to their bank accounts for this.

The Crackdown

Sushil Kumar Modi, convenor of the group of ministers on Integrated GST, recently said the government is closely monitoring around 67 lakh new registrants to ensure these are not shell or fake companies. He said they account for only Rs 10,000 crore or only 15 per cent of the total GST paid.

GST Network (GSTN), the entity that offers the IT support to the GST system, has come up with a new way to check refund fraud. Under the new return filing system, which will be implemented from April 2020, if a supplier doesn't pay taxes for more than two months, the purchaser will not be able to claim input credit from the third month. At present, one can claim input tax credit even if the supplier has not paid taxes for six months.

In the current system, GSTR-1 return has all the information of sales made by a supplier, while GSTR-2A has all the purchases made by a buyer. Entries from GSTR-1 of the supplier auto-populate the GSTR-2A of the buyer. GSTR-3B is the monthly return that every registered GST payer has to file. It has details of sales and purchases made.

Prakash Kumar, CEO, GSTN, says: "Today, there is no linkage between GSTR-1 (filed by supplier) and GSTR3B (filed by all GST payers). A supplier can file GSTR1, and it would show in the buyer's GSTR2A. So the buyer can claim input credit by showing his GSTR2A even if the supplier has not filed GSTR3B and paid taxes. In the new system, if the supplier has not filed, it would show in the ANX-2 of the buyer (an annexure to GSTR-1, which has supplies details, and which the recipient has to accept/reject/mark pending)."

However, says Kumar, those who want to defraud the system can still do so for two months. "We are working on how to plug this gap as well. This is a game of cat and mouse, they (those who want to game the system) would find a way out."

Kumar says that even in the EU, GST (VAT) refund is a huge problem. "This (refund fraud) is an intrinsic problem because the buyer can claim refund based on his purchases. But if the supplier vanishes, what can the buyer do. This is what the buyer says in the court. Our effort is to keep on informing the buyer that this is what the supplier has done," he explains.

Bibek Debroy, Chairman, Prime Minister's Economic Advisory Council, suggests mandatory registration for even small companies. "This is of course a call that the GST Council has to take, but in my opinion, every MSME must take a GST registration, even if it is in zero tax (category). Second, the average GST rate is too low and most people would not want a 28 per cent rate nor a zero per cent rate, but a standardised rate. It means average rates coming down, and violations going down. You must fix it. GST Council will decide when and how to fix it. However, when growth rates are low, it is probably not the best time to do it. The third thing is to take a relook at the idea of compensation to states as it is a perverse incentive to states to have more and more rates at zero per cent."

To ensure better compliance, the government has now started a new system wherein if a taxpayer is not filing GSTR-3B for two consecutive months, the facility to generate e-way bill gets automatically blocked. Once the taxpayer has filed one of the pending returns, the facility to generate e-way bill will be automatically restored.

"This lacuna is now being sought to be addressed by the new return mechanism which has features of matching, and also e-invoicing, both of which are slated for roll-out in the next fiscal. People used to take input tax credit fraudulently with fake invoices, but now it will not be possible for them to generate e-Way bills anymore," says Revenue Secretary Pandey.

In November this year, Central GST Delhi North Commissionerate unearthed a racket involving supply of invoices without goods and goods without invoices. The accused was found operating 10 fake firms that were created to rotate money and fraudulently claim input tax credit. Fraudulent input tax credit of Rs 140 crore was claimed using invoices involving an amount of Rs 1,040 crore.

Unfriendly Environment

Are Indian businesses averse to paying taxes? Life has become complicated post-GST, says Deepak Maru, a former President of Federation of Jharkhand Chamber of Commerce and Industry. "Most businesses here are small and to handle GST complications, they will need a chartered accountant and a lawyer. Most of them can't afford that," he says.

Yudhishthir Bhatia, who owns a kirana store in Udaipur, says that the penalty he has to pay for being GST compliant is an additional expense of Rs 10,000 per month to hire a chartered accountant. "My costs are going up but not my income is not."

Maru says that most business owners in his region don't understand how to avail input tax credit, and neither do they know how to get a GST number. "There are a lot of issues with input credit. My money is with the government as credit and they take their own time to pay me back. But if I am late in filing my GST return by even a day, I am charged a penalty." He says that one of the reasons for the current liquidity crisis is because input credit of a lot of businesses are yet to be reimbursed.

Unbranded commodities have to come in white packs with the company's name and FSSAI number printed at the rear.

Corruption and under the table dealings are at a peak in the GST era, say many business owners. "It's not that people were not corrupt earlier but the intensity has increased manifold. The government has to do something to improve the ease of doing business," says Sahu of Baba Agro Foods. "Why can't the government impose GST at sourcing itself? That would have solved our woes to a large extent," he says.

While Baba Agro Foods pays Rs 1,600 per quintal for paddy, competitors pay Rs 1,580, as they pay cash. The supplier is happy to deal with them as he also prefers cash. This leaves Baba Agro Foods in a weaker position.

S.C. Ralhan, CEO of Ludhiana-based Sri Tools Industries, which manufactures and exports welding tools, says, the only way to reduce GST theft is tax rationalisation. "At the higher level (of bureaucracy), there is hardly any corruption, but it is very difficult to stop corruption at the lower level. Rationalisation of taxes is the best solution to avoid GST evasion."

In the wake of growing revenue concerns, the GST Council is likely to revamp the tax structure. The move is likely to increase the government's tax collection. The answer may, however, lie in plugging the loopholes in the existing GST policy, and preventing businesses from circumventing India's most promising indirect tax.