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Internship Report

on

**‘Lags in Regulatory Framework of GST Dealing with Frauds and
their Remedial Measures’**

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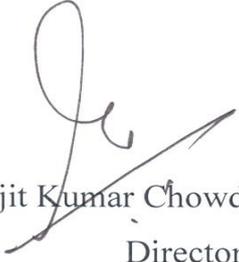
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Certificate

This internship report titled “*Lags in Regulatory Framework of GST Dealing with Frauds and their Remedial Measures*” is a report on the study taken up at the Fiscal Policy Institute (FPI) in 2019-20.

The internship report is prepared by Mr. Rahul Kumar, School of Economics, University of Hyderabad, under the mentorship of Sri. Subraya M. Hegde, Consultant, Fiscal Policy Institute.

All opinion and conclusions expressed in the internship report are of the Intern and usual disclaimer applies.


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Institute's Seal

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CONTENTS

ABBREVIATIONS.....	1
ABSTRACT	2
1. INTRODUCTION.....	2
2. STUDY OBJECTIVES	3
3. LITERATURE REVIEW	3
4. RESEARCH METHODOLOGY	3
5. WHY GST.....	3
6. PROBLEM OF TAX EVASIONS AND FRAUDS IN INDIA	5
7. REGULATORY AUTHORITIES.....	6
8. GST COUNCIL AS BEST EXAMPLE OF CO-OPERATIVE FEDERALISM	8
9. MAJOR MODES OF TAX EVASION UNDER GST	8
9.1. MISMATCH IN INVOICES.....	9
9.2. BILL TRADING	10
9.3. OVER-CLAIMING OF INPUT TAX CREDIT (ITC).....	11
9.4. FAILURE OF BUSINESSES TO REGISTER	12
9.5. TAX COLLECTED BUT NOT REMITTED	12
10. LAGS LEADING TO TAX FRAUDS	12
10.1. CHALLENGES IN GSTN	12
10.2. MISCLASSIFICATION OF GOODS AND SERVICES	13
10.3. RATE STRUCTURE	14
10.4. REFUND MECHANISM	15
10.5. LEGAL AVOIDANCE.....	15
11. REMEDIAL MEASURES	16
11.1. IMPROVEMENT IN INFRASTRUCTURE OF GST NETWORK.....	16
11.2. PRECISION IN CATEGORISATION OF GOODS AND SERVICES.....	17
11.3. INTEGRATION WITH INCOME TAX, CUSTOMS AND BANKING NETWORK	17
11.4. INCENTIVISE THE DILIGENT DEALERS	18
11.5. REGISTRATION THRESHOLD.....	19
11.6. INCREASE IN BOTH LEGAL AND TECHNICAL AWARENESS	19
11.7. OTHER MEASURES TAKEN AROUND WORLD	20
11.7.1. REVERSE CHARGE MECHANISM.....	20
11.7.2. CHAIN LIABILITY	20
11.7.3. GST ACCOUNTS	21
11.7.4. CERTIFIED SOFTWARE.....	21
11.7.5. VAT LOCATOR NUMBERS	22
12. CONCLUSION	23
13. REFERENCES	24

ABBREVIATIONS

CBIC – Central Board of Indirect Taxes and Customs

CGST – Central Goods and Services Tax

CTD – Commercial Tax Department

FICCI – Federation of Indian Chambers of Commerce & Industry

FRBM Act – Fiscal Responsibility and Budget Management Act

GDP – Gross Domestic Product

GFI – Global Financial Integrity

GST – Goods and Services Tax

GSTN – Goods and Service Tax Network

HSN – Harmonized System of Nomenclature

IGST – Integrated Goods and Services Tax

IT – Information Technology

ITC – Input Tax Credit

MSME – Micro, Small and Medium Enterprises

PAN – Permanent Account Number

PIB – Press Information Bureau

SGST – State Goods and Services Tax

TIN – Tax Identification Number

VAT – Value Added Tax

VLN – VAT Locator Number

ABSTRACT

After the implementation of GST in India, it was assumed that GST would help to raise revenues for the government by widening the tax net, create a uniform market by subsuming different taxes at Centre and state level into a simple tax and make the manufacturing sector free from the cascading effect of taxes. Although GST positively responds to all of those expectations, it does not entirely help to curb the problem of tax evasion and related frauds that were prevailing in the previous Value Added Tax (VAT) system. An attempt is made in this paper to study the different modes of tax evasion and the lags in the regulatory framework of GST which are dealing with such frauds. The study also aims to know the measures available for controlling such frauds.

1. INTRODUCTION

The Kelkar Task Force Committee on the implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that although the indirect tax policy in India has been steadily progressing in the direction of the VAT principle since 1986, the existing system of taxation of goods and services still suffers from many problems. The tax base is fragmented between the Centre and the states services, which constitute nearly half of the GDP, are not taxed appropriately. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on the VAT principle.

After a long consideration, The One Hundred and First Amendment of the Constitution of India, officially known as The Constitution (One Hundred and First Amendment) Act, 2016, introduced a national Goods and Services Tax in India from 1st July, 2017, where India moved towards '**One Nation, One Tax, One Market**'. GST is a comprehensive, multi-stage, destination-based consumption tax that is totally based on the credit invoice method where only the value addition at each stage is taxed, with seamless flow of credit along the supply chain. It replaces all indirect taxes levied on goods and services by the unified tax system on the supply of goods and services, right from the manufacturer to the consumer. Three taxes are applicable under GST in India viz. the Central GST (CGST) to be levied and collected by the Central government on intra-state transactions, States GST (SGST) to be levied and collected by the state government on an intra-state transactions and Integrated GST (IGST) to be levied and collected by the Central government on inter-state transactions.

2. STUDY OBJECTIVES

In light of the limited literature that has documented the issues of frauds in GST, this study is conducted to attain the following main objectives:

- a) To study the different modes of tax evasion
- b) To study the lags in the regulatory framework of GST which are dealing in such frauds
- c) To find the measures available for controlling such frauds.

3. LITERATURE REVIEW

“GST Fraud” is a newborn in the area of research, and hence it is difficult to find the literature to study on it. In this report, literature based on “VAT Fraud” is taken for review:

Michael Walpole (2014) in his research article “Tackling Vat Fraud” concluded that VAT fraud is widespread and extremely harmful to society and the revenues of national governments and gives an overview of various anti-fraud measures and supports the adoption of specific measures. He also emphasised that in the new era of information exchange and computerisation of record keeping, effective enforcement and collection of VAT is needed without imposing obligations on business that are economically adverse.

4. RESEARCH METHODOLOGY

This report is prepared by using the exploratory research technique based on past literature from respective journals, newspapers, magazines and websites covering a wide collection of academic literature on GST. According to the objectives of the study, the research design is descriptive in nature. The accessible secondary data is used for study.

5. WHY GST

When we start talking about GST, the first question that comes to our mind is Why GST? The earlier structure of indirect taxes was quite complex. Central and State Governments were levying a large number of taxes such as Central Excise Duty, Service Tax, Central Sales Tax, VAT, Entry Tax, Local Body Taxes, Luxury Tax, Entertainment Tax, Purchase Tax, Taxes on Lottery, Betting and Gambling, State cesses and surcharges etc. Each of these was an independent tax with differing provisions and

separate compliance requirements. These different tax systems were also not interconnected, which provided various avenues for tax evasion and made it difficult for the taxpayers to adhere to the legal requirements. To simplify this tax regime, Goods and Services Tax (GST) was implemented in India in July 2017, and it has uniform tax rates across states for both intra-state and inter-state transaction.

The main results that came into effect after the implementation of GST are:

- GST has removed the cascading effect of taxes as Input Tax Credit is calculated on the value-addition at every stage of the supply.
- GST harmonised the laws, procedure and tax rates across the country, resulting in a unified tax structure.
- GST improved the overall investment climate in the country, which will naturally benefit the development in the states.
- GST improved the environment of compliance as all tax returns are to be filed online and input credits are to be verified online, encouraging more paper trail of transactions.
- GST removed the inter-state economic barriers and created a unified national market.
- GST helped to bring buoyancy to the government revenue by widening the tax base and improving taxpayer compliance.

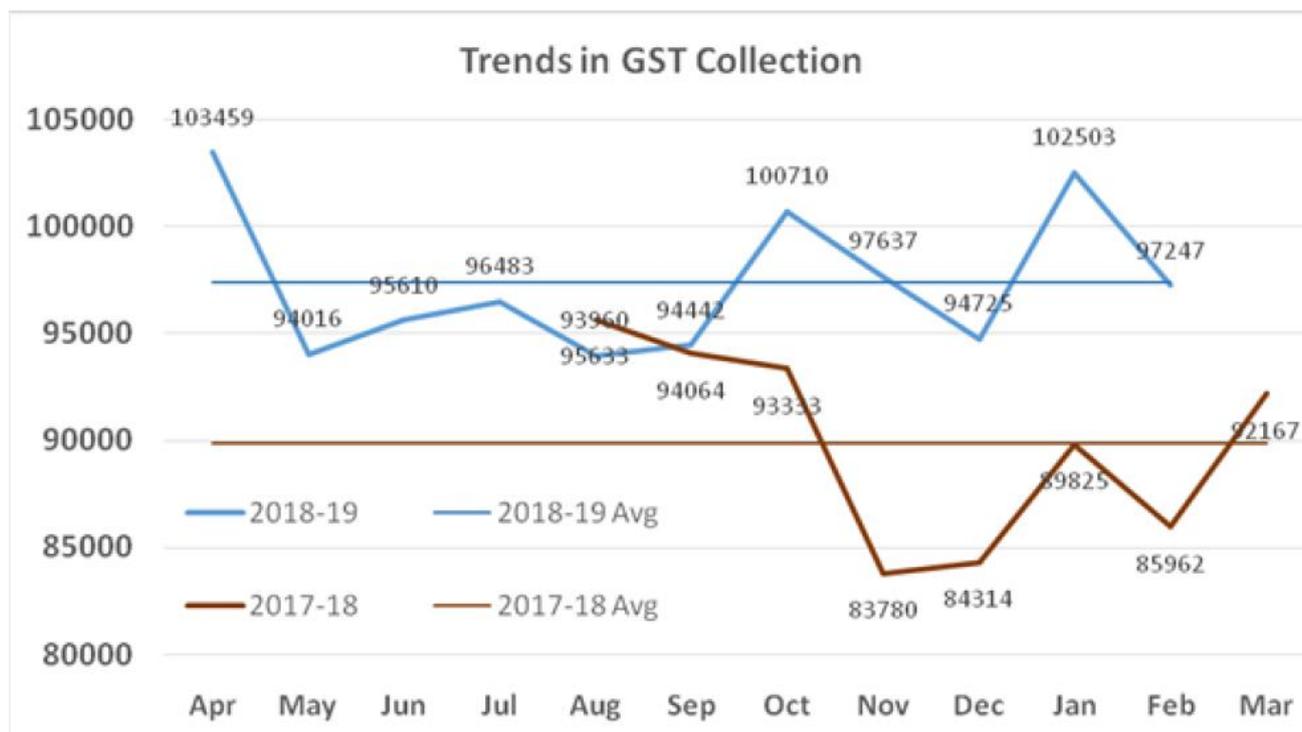
Comparison of trends in Revenue in 2017-18 and 2018-19

Total Gross GST revenue collected in the month of March, 2019 is Rs. 1,06,577 crore of which CGST is Rs. 20,353 crore, SGST is Rs. 27,520 crore, IGST is Rs. 50,418 crore (including Rs. 23,521 crore collected on imports) and Cess is Rs.8,286 crore (including Rs. 891 crore collected on imports). The total number of GSTR 3B Returns filed for the month of February up to 31st March, 2019 is 75.95 lakh.

The collection during March, 2019 has been the highest since the introduction of GST. The revenue in March, 2018 was Rs. 92,167 crore and the revenue during March, 2019 is a growth of 15.6% over the

revenue in the same month the previous year. The revenue for the last quarter in the year 2018-19 is 14.3% higher than the revenue collected during the same period the previous year. The monthly average of GST revenue during 2018-19 is Rs. 98,114 crore which is 9.2% higher than FY 2017-18. These figures indicate that the revenue growth has been picking up in recent months, despite various rate rationalisation measures, reducing tax rates of around 300 goods from 28% to 18% within one year of roll-out of GST.

Figure 1: Trends in revenue during 2017-18 and 2018-19.



[Source: Ministry of Finance, PIB Press release dated 01 March 2019]

6. PROBLEM OF TAX EVASIONS AND FRAUDS IN INDIA

Rooting for taxes is never an easy thing because most people question the concept of giving away part of their earnings to a government, but the fact is that taxes are an important source of income for the government. As Mr. Justice Oliver Wendell Holmes once said: “*Taxes are the cost we pay for civilised society*”. This is the money that is invested in various development projects that are meant for the development of a country. But today, every country has been facing a massive problem of tax

evasion. People who should be paying taxes have found ways not to pay them and, as a result, the revenue of the country has been suffering.

India has been continuously facing the challenges of various modes of tax evasion as well as frauds even from the earlier indirect tax structure. A report by the Washington, DC based think tank Global Financial Integrity (GFI) estimated that India has lost \$13 billion potential tax revenue under Value Added Tax(VAT) system in 2016, equivalent to a staggering 5.5 per cent of total government revenue collection back then, due to simple trade mis-invoicing.

After the implementation of GST, it was assumed that GST would help to tackle the problem of tax evasion, but this expectation has not been realised. As per a recent report of Central Board of Indirect Taxes and Customs (CBIC), The Central government has detected GST evasion of about ₹20,000 crore (between April-February 2018-19), of which ₹10,000 crore has been recovered.

Along with trade invoicing, suppression of sales, misclassification of goods, undervaluation of goods, over-claiming of Input Tax Credit (ITC) etc. are some of the major modes of tax evasion under GST that are hitting the economy badly. These modes of tax evasion are mainly seen in the traditionally evasion-prone commodities like iron and steel, oil seeds and edible oil, plywood etc. that had systematically created multi-layered trade networks which made it impossible for the administration to verify the truth of their claims of exemption of ITC manually.

7. REGULATORY AUTHORITIES

Goods & Services Tax Council is the supreme regulatory authority for making recommendations to the Union and State Governments on issues related to Goods and Service Tax. As per Article 279A of the amended Constitution, the GST Council is a constitutional body, chaired by the Union Finance Minister and its other members are the Union State Minister of Revenue or Finance and Ministers in-charge of Finance or Taxation of all the states.

GST Council, which is a creature of the Constitution, is the supreme policy-making body and only on its recommendation do parliament and the legislatures pass laws/rules relating to GST. At the operation level, the Central Board of Indirect Taxes and Customs (CBIC) and states' Commercial Tax Departments (CTD) are the authority who implement and regulate this at Central and State level respectively.

Central Board of Indirect Taxes and Customs (CBIC) is part of the Department of Revenue under the Ministry of Finance, Government of India. It deals with the tasks of formulation of policy concerning levy and collection of Customs, Central Excise duties, Central Goods & Services Tax and IGST, prevention of smuggling and administration of matters relating to Customs, Central Excise, Central Goods & Services Tax, IGST and Narcotics to the extent under CBIC's purview.

States' Commercial Tax Departments (CTD) play the same role in the internal resource mobilisation of the State Government and deal with the tasks of policy formulation and collection of State Goods & Services Tax (SGST).

Mandate of GST Council

The GST Council shall make recommendations to the Union and the states on:

- a) The taxes, cesses and surcharges levied by the Union, the states and the local bodies which may be subsumed in the goods and services tax;
- b) The goods and services that may be subjected to, or exempted from the goods and services tax;
- c) Model goods and services tax laws, principles of levy, apportionment of goods and services tax levied on supplies in the course of inter-state trade or commerce under article 269A and the principles that govern the place of supply;
- d) The threshold limit of turnover below which goods and services may be exempted from goods and services tax;
- e) The rates including floor rates with bands of goods and services tax;
- f) Any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;
- g) Special provision with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- h) Any other matter relating to the goods and services tax, as the Council may decide.

8. GST COUNCIL AS BEST EXAMPLE OF CO-OPERATIVE FEDERALISM

GST is the best example of cooperative and collaborative federalism where States and the Centre have given up their exclusive power to tax and agreed to share their powers to achieve uniformity in tax system to realise the vision of 'One Nation and One Market'. Under the GST regime, The Centre and the state governments act on the recommendations of of the GST Council. GST Council comprises the Union Finance Minister, Union Minister of State for Finance and all finance ministers of the states. The voting power of 2/3rd of total votes share with the states and 1/3rd of the total votes share with Centre reflects the adaptive spirit of federalism.

Whenever the concurrence of the members of the council was hard to achieve, or when an issue required in-depth discussion or wider consultation, the council formed sub-groups of ministers similar to parliamentary committees to look into the issues and build consensus. Till now, 10 such groups of ministers have been formed to consider specific issues.

In the last 35th GST Council meetings, all the decisions have been taken unanimously, never calling for any voting.

9. MAJOR MODES OF TAX EVASION UNDER GST

Sections 42 and 43 of chapter IX of CGST/SGST Acts provide for matching of tax invoices of the pairing dealers to reclaim the ITC, which is the cornerstone of the foundation of GST. The main provisions are as under:

(1) The details of every inward supply furnished by a registered person (hereafter in this section referred to as the "recipient") for a tax period shall, in such manner and within such time as may be prescribed, be matched-

- a) with the corresponding details of outward supply furnished by the corresponding registered person (hereafter in this section referred to as the "supplier") in his valid return for the same tax period or any preceding tax period;
- b) with the integrated goods and services tax paid under section 3 of the Customs Tariff Act, 1975 in respect of goods imported by him; and
- c) For duplication of claims of input tax credit.

(2) The claim of input tax credit in respect of invoices or debit notes relating to inward supply that match with the details of corresponding outward supply or with the integrated goods and services tax paid under section 3 of the Customs Tariff Act, 1975 in respect of goods imported by him shall be finally accepted and such acceptance shall be communicated, in such manner as may be prescribed, to the recipient.

At the time of implementation of GST, supplier had to file GSTR 1 for outward supplies based on which further GSTR 2 for inward supplies were prepared. But due to heavy traffic, the GST portal crashed several times and forced the government to extend the deadline for filing of returns again and again. Thereafter, CBEC allowed filing of GSTR 3B instead of GSTR 2, to provisionally calculate and pay the tax liability for each month. That extension also gave more time to businesses to understand the various nuances of GST return which were being filed for the first time.

Now at the time of filing an annual return in Form GSTR-9, a reconciliation of outward supplies is a must to ensure that the details disclosed match the details disclosed in GSTR-1 and GSTR-3B, across all months. Therefore, it is important that GSTR-1 and GSTR-3B should match. As the return-filing system is integrated, a mismatch between the same could result in improper disclosure in the annual return.

Although the laws provide a proper mechanism of matching, reversal and reclaim of input tax credit (ITC), GSTN, the national IT portal could not facilitate this practically in an efficient manner which led to different modes of tax evasion such as mismatch of invoices, bill trading, over-claiming of input tax credit etc. Some of the major modes follow:

9.1. MISMATCH IN INVOICES

Matching of invoices is a crucial process for the fair distribution of Input Tax Credit on Goods and Services Tax Network (GSTN). The sale by one person becomes the purchase by another person. Hence a supplier of goods, while doing the transaction of supply of goods and services to the recipient, has to declare all supplies in GSTR1. In simple words, supplier details in GSTR1 match with the GSTR2A/GSTR2 of the recipient and then only the recipient will be eligible for the Input Tax Credit.

ITC will be availed only to the extent of Invoice Matching. Hence this will be a real-time flow and a monthly affair where the parties will upload the invoices and the counterpart will accept.

After the implementation of GST, ITC which has been available only on intra-state supplies, under previous states' indirect tax laws, gets extended to inter-state supplies. But due to a huge volume of transactions and mismatch in invoices, striking a balance between a fair distribution of ITC and protection of public revenue is a big challenge to the GST administration. The mismatch may arise due to the following reasons:

- I. ITC availed by the recipient is more than the tax declared by the supplier
- II. ITC availed by the recipient but outward supply is not declared by the supplier
- III. Bogus claim of Input Tax Credit by the recipient

In the current scenario, mismatch in invoices becomes one of the major reasons of tax frauds.

9.2. BILL TRADING

A network of transporter, bogus dealer and bogus retailer makes bill trading a common mode of tax evasion. In this companies may be set up solely to generate invoices that allow claim of ITC. Such “invoice mills” exploit the practical impossibility of cross-checking every invoice against evidence that earlier tax has been paid.

For e.g.: In September 2018, the Commercial Taxes Department, Karnataka, arrested two Bengaluru-based businessmen on charges of committing fraud under the GST laws by claiming crores of rupees worth Input Tax Credit without any real trade taking place, and without anyone paying the GST.

In September 2018, the Commercial Taxes Department, Karnataka, busted a scam worth ₹2000 crore. Three people were arrested for being allegedly involved in giving ₹203 crore bogus GST invoices to hundreds of GST dealers.

In June 2019, the Directorate-General of GST Intelligence (DGGI) officers of Bengaluru zone arrested four persons, including a chartered accountant, for their alleged involvement in issuing GST invoices without supplying goods, leading to wrongful utilisation of Input Tax Credit, in Bengaluru. The arrested were issued invoices worth ₹2,364 crore, on which credit of approximately ₹385 crore was passed on.

Frauds due to bill trading were also prevailing in the earlier state indirect tax laws and are still there in this system.

For e.g.: In 2012, the enforcement officers of CTD Karnataka, while analysing the e-Sugam (online filing of details of goods being transported) raised by certain dealers in iron and steel and granite operating in Bangalore, noticed that the e-Sugam were raised only for supplying the goods sold and no e-Sugam were raised for transporting the goods purchased, though use of e-Sugam was mandatory for the said goods. On investigation, the following startling revelations came to limelight:

- A total of 82 bogus dealers/bill traders were engaged in either not remitting the collected output tax or in issuing tax invoices without selling goods, enabling the buyers to make illegal claims of ITC, involving around ₹492 crore of turnover and tax of ₹22 crore (approx).
- In an extreme case, two persons (one of them having 2 PANs) with the support of a tax return filer had managed to obtain 6 TINs (including 3 proprietorship concerns by one person) for trading in commodities ranging from iron and steel to electronic goods. They were engaged in selling tax invoices for a small commission rather than in the actual sales of goods. On being booked on criminal charges, they were in police custody for 28 days before coming out on bail. Further investigation revealed that the so-called account payee cheques issued by the conniving buyers were not deposited with the declared bank accounts of the sellers. The vehicle numbers of goods vehicles mentioned in the e-Sugam for transportation of tons of goods, on cross-check with the state transport authorities, were either of two-wheelers or three-wheelers.
- These cases of bogus dealer/bill traders have been handed over to the Economic Offences wing of COD Karnataka for further investigation in 2013.

9.3. OVER-CLAIMING OF INPUT TAX CREDIT (ITC)

This is the most obvious way to exploit the Input Tax Credit mechanism. For established businesses liable to GST on their own output, there is some limit to this, since excessive credit claims would imply that the business was operating at an implausibly low margin. But there is much more scope for new businesses to exaggerate input claims without arousing suspicion, since large initial purchases of capital goods and other inputs would be expected at start-up, without being matched immediately by a corresponding level of sales.

Exports frauds also lead to fraudulent claims though the goods are not actually exported out of the country and this is a challenge under GST also. Such fraud may involve non-existent commodities or genuine commodities that have in fact been sold in the domestic market. A false ITC credit claim for

Rs.1 costs the government the same as a fraudulent refund of Rs.1. Thus, it is one of the major problems created by ITC refunds which receive particular attention.

9.4. FAILURE OF BUSINESSES TO REGISTER

The most common such cases under the GST are relatively small businesses operating close to the level of turnover at which registration becomes compulsory, that fail to register, saving both the GST for which they would be liable and GST compliance costs. “Ghosts”— traders wholly unknown to the revenue authorities — may be able to evade income taxes as well as GST. Once again, firms selling to final consumers (or to other unregistered businesses) are likely to predominate in this group.

9.5. TAX COLLECTED BUT NOT REMITTED

This may be possible either through false accounting (under-reported sales, as above), by engineering bankruptcy before tax is paid, or in other ways. More particularly, the “missing trader” frauds typically involve registered businesses charging their customers with GST but disappearing before paying tax to the authorities.

10. LAGS LEADING TO TAX FRAUDS

10.1. CHALLENGES IN GSTN

A matching process that is proposed in GST for validation of input tax credits is the cornerstone of the edifice of GST. The success of GST hinges on matching of invoices, which depends on the robust IT backbone connecting both Central and state governments, trade and industry, banks and other stakeholders on a real-time basis. Toward this end, the government has already incorporated an SPV viz. – Goods and Services Tax Network (GSTN) and it is functional since 2017. The Goods and Service Tax Network (or GSTN) is a non-profit, non-government organisation. It manages the entire IT system of the GST portal, which is the mother database for everything in GST. This portal is used by the government to track every financial transaction, and provides taxpayers with all services – from registration to filing taxes and maintaining all tax details.

Mismatch in invoices is one of the major challenges in GST Network (sec. 5.1). On completion of one year of GST, the Federation of Indian Chambers of Commerce & Industry (FICCI) conducted a survey

of enterprises and their experience post GST implementation. According to the survey, 59 per cent of the respondents mentioned that they were not satisfied with the capability of the GSTN portal. In fact, 96 per cent of respondents felt that improvements were required in the working of the portal. Respondents of the survey pointed out issues with the robustness and volume handling capacity of the GST portal. Problems like delayed reflection of updated data as well as payments, absence of effective mechanism to resolve issues and inability to make corrections after submission of returns in case of errors were highlighted. Even as the government looks to resolve the glitches of the GST Network, dealers using the network continue to grapple with technological issues on the portal. The five problems commonly faced by the GSTN users are:

- ◆ Overloading of GSTN portal
- ◆ Incorrect data in the error report
- ◆ More-than-expected time in generation of error reports
- ◆ Error in numbers including decimals
- ◆ Deferral of GST deadline causing refunds to get stuck

Adapting to the IT ecosystem is hard for MSME, since Indian economy is majorly driven by small business units i.e. MSMEs. It is unfair to expect small-scale business firms to make the transition to an online IT platform and expect no errors in return filing. It is an uphill task for the majority of our working population which has little hands-on experience with IT solutions.

10.2. MISCLASSIFICATION OF GOODS AND SERVICES

When traders have sales that are liable to GST at different rates, or some of which lie outside the scope of the tax (exempt items under the GST), they may reduce their liability by exaggerating the proportion of sales in the lower-rate categories. Several frauds become more attractive, if the rate of GST on a commodity is very high.

Introducing GST in India was no small feat, but it has become increasingly clear that the system is too complicated and has led to a lot of confusion for taxpayers. India has five different GST rates—0, 5%, 12%, 18%, and 28%. In addition to these five tax rates, there are some exceptions. Some goods are categorised as luxury and sin goods, deserving a special cess in addition to the GST rate. There are some special goods taxed at low rates like gold (3%) and precious gemstones (0.25%). After all, the

government did a remarkable job of producing a detailed list of classifications in the Harmonised System of Nomenclature (HSN) - an eight-digit code for goods classification - which tries to provide and stipulate a code for every conceivable product category.

Even after doing such a detailed job, there is still confusion. What happens when a good or service could fit in two different categories, taxed at two different rates? For instance, should Pepsi's Nimbooz be classified lemonade (taxed at 28%) or as pulp juice (taxed at 12%)? Most firms provide a canteen, but most firms also have the food prepared outside the premises, often by a third party. Should they be taxed at 5% or 18%, because canteen service is taxed at 5%, while outdoor catering is taxed at 18%. Another problem also exists, where variations of a good are taxed under different rates. Last year, there was a sweets dispute. Plain barfis were taxed at 5%, but barfis with dry fruits could be taxed at 12%, and chocolate barfis at 28%. The GST council had to clarify that chocolate barfis would be taxed at 5% as barfis and not as chocolate.

If one goes to the GST council website, there are a few hundred notifications, more than one for each day in existence. And that is just the Central government notifications. Each state has its own set of notifications. There is a constant process of raising disputes and questions, and the government is trying to clarify classifications and solve problems. And this is only about the current stock of goods and services. It does not account for new products and services that will enter the market in the future. The problem is that it is an impossible task to classify each and every goods, No matter how detailed the classification code-books are, there will always be disputes and confusion, because we live in a world with interesting, complicated and customised goods and services with many dimensions and serving many needs. This ambiguity will be liable to be exploited by unscrupulous tax evaders.

10.3. RATE STRUCTURE

Multiple rates create scope for misclassification fraud of the kind mentioned above. Moreover, where rate differentials are sufficiently large, they can also give rise to refund entitlements for some traders (those using inputs taxed at a high rate to produce outputs subject to a low rate of GST), which in turn creates opportunities for fraudulent abuse. Although a reduced rate of GST is the most elegant way of taking account of distributional considerations in the design of a GST (since it avoids the production inefficiency associated with the taxation of inputs implied by exemption), it has the disadvantage of extending the scope of the refund problem beyond exports.

10.4. REFUND MECHANISM

The scope for some GST frauds is affected by the speed with which ITC refunds are paid, compared with GST collections. Frauds that involve false refund claims by firms that subsequently disappear will be more tempting the more rapidly refunds are paid, both because this gives the authorities less time to detect the fraud and because a longer time lag in refunds compared with collections means that firms may, for a period, be more substantial net tax creditors to the tax authorities.

The current refund mechanism is hitting exports badly. There is a need to find a mechanism to refund the taxes which exporters are continuing to pay including electricity duty, VAT on petroleum goods, mandi tax, stamp duty and many embedded taxes that are still being paid by exporters after the implementation of the Goods & Services Tax (GST) regime. If a mechanism is found to refund these taxes, it could make exports more competitive. According to the Apparel Export Promotion Council, embedded taxes for the garment sector, which include the levies on cotton, electricity, and input tax credit restrictions for man-made fibres which is purchased from unregistered dealers, put an additional burden of about 4-5 per cent on the industry.

Many exporters are suffering from a credit crunch in the GST regime as the mechanism for the refund of taxes is not yet robust. Hence there is need to find alternative ways to compensate exporters and this will lead to a reduction in tax evasion.

10.5. LEGAL AVOIDANCE

The GST regime has brought in a tougher and stricter compliance diaphragm, which every person has to follow religiously. Any sort of non-compliance can have a severe effect on the daily business of the taxpayer and can attract huge amounts of interest and penalties. If the offences are grievous in nature, it can lead to holding criminal proceedings against the offenders. Under the GST Act, no concession has been given for first-time offenders. Therefore, even if any person is unintentionally avoiding to pay taxes or short deducting taxes wherever applicable, he will still be served a notice from the relevant authority. Moreover, the right to appeal is only invoked when a specific sum of money is deposited beforehand with the repository, which will block his working capital until the appeal is completed.

This is necessary for regulatory authorities to identify their working capital, cash flow, and fund flow needs for proper facilitation of business. Otherwise, a person gets out from the market.

11. REMEDIAL MEASURES

11.1. IMPROVEMENT IN INFRASTRUCTURE OF GST NETWORK

We live in an era of rapidly evolving technology, and with technological changes come challenges as well as opportunities. India's government saw an opportunity to increase transparency and curb corruption by requiring digital reporting in the new Goods and Services Tax (GST) system. But the sloppy GST Network raises serious concerns over the government's claim of a digital powered economy.

Blockchain technology has a huge potential to iron out glitches and improve efficiency in India's mammoth GST Network. Blockchain technology could benefit GST's digital transaction infrastructure immensely, by potentially protecting sensitive GST records and authenticating the identity of users. Data manipulation would be easily spotted, as the original hash would be available on other nodes linked to the system. Invoicing would likely also benefit. At present, under GST, tax invoices are fundamental documents required at each and every stage of the supply chain, from the point of purchase to the filing of returns. Blockchain has the potential to provide automatic settlement and payment and to fully authenticate the matching of documents between suppliers and purchasers.

Blockchain is just another type of database for recording transactions. GST administrators might create a blockchain for the transmission of tax data and payments between taxpayers and the GST portal. Blockchain technology calls for real-time recording of transactions — a cumbersome task to achieve without a proper system in place. Blockchain would therefore help increase the speed, accuracy, and ease of collecting data.

Yet, before widespread adoption, blockchain would need to address certain implementation challenges, such as on-boarding users, regulatory acceptance, infrastructural issues, and incorporating firms and businesses that operate on a small scale. The Institute for Development and Research in Banking Technology (IDRBT) will be setting up a working group to look at blockchain use cases and determine whether there is any potential to build the necessary trust through software mechanisms and cryptography to go ahead and begin incorporating blockchain technology within the GST system.

Though our appetite for transformative change has increased over the years, the Indian Government will need to be very cautious about introducing any new technology. Blockchain technology will need to be thoroughly tested and its worth proven before incorporating it.

11.2. PRECISION IN CATEGORISATION OF GOODS AND SERVICES

One might think a five different rates slab is not so bad. The point is not how best to classify each good, but to realise the impossibility of successfully classifying each good. Therefore it is best to do away with the need to classify each good. As the world around us grows in complexity, there is a tendency for governments to think we need more detailed rules and systems to regulate the dynamic nature of our economy and society. Counter-intuitively, the greater the complexity, the more we need simple rules to guide us through the maze of choices.

Richard Epstein (one of the best-known legal theorists in the world) says that the simplicity of rules better helps individuals and firms deal with many choices and the changing condition of the world around us. A complex tax system, on the other hand, adds a burden to the human ability to navigate the numerous choices in a dynamic world. The greater the number of goods and services in the economy, the better it is to have fewer classifications and rates. In fact, a single rate does the job quite well. If the government can simplify the GST rates to a single rate and do away with the need for classification, it would reduce uncertainty, resources spent on resolving disputes, and compliance costs.

However, the GST Council needs to agree to a single rate. A single GST for all goods and services needs no classification system. Every individual and firm simply pays the same rate, and the government and the legal system can use valuable time and resources resolving other problems.

11.3. INTEGRATION WITH INCOME TAX, CUSTOMS AND BANKING NETWORK

Matching the GST database with information available with the income tax, customs and banking network can help authorities to identify those evading taxes. Technically, it is possible to use GST data to draw linkage with the income-tax and banking network data through the common data set with the help of analytics. Currently, the GSTN and tax department already have the data to carry out the risk analysis where outliers in terms of the industry average of tax payments are scrutinised and those not

paying or under-reporting company revenues could be questioned. Integration of banking network to GSTN and income tax can be a milestone in the policy making against tax frauds. This can help to curb evasion in all the three departments. The Customs Department has an integrated online system with a database on bills of entry and the invoices. Integration of this system with GSTN can help in checking tax evasion. If an importer has under-declared the price at the time of imports and sold it at a higher price to save on countervailing duty, this can be tracked under GST.

11.4. INCENTIVISE THE DILIGENT DEALERS

An approach that supports the smooth running of the GST system and secures a normal flow of refunds for honest suppliers is one that recognises that the risk of fraud on the part of some suppliers is low and that there is little need to impede the flow of refunds or to otherwise subject transactions to excessive scrutiny, because such businesses have a clean record of GST compliance and a good system of keeping business records, which suggests that their compliance is soundly managed and they thus demonstrate a low risk of non-compliance. In the case of such businesses, the tax authorities can accept that it is more likely than not that the reported transactions are legitimate and that the reporting is complete.

Singapore is an example of a jurisdiction that runs a “gold card” scheme under the heading “GST Assisted Compliance Assurance Program” (ACAP), which has been running since 2011. The incentive for businesses to participate in the scheme is an enhanced relationship with the Singapore Inland Revenue. This means that qualifying businesses should experience (for three years or five years, depending on their status under the ACAP) a reduction of GST auditing activities by the tax authorities; quicker GST refunds; a customer relations manager to handle their GST rulings and resolve their GST issues; expedited rulings and resolution of issues; and automatic renewal of applicable GST schemes.

An extreme form of the gold card scheme is found in the Netherlands, where the tax authorities enter into covenants with businesses in the framework of what they call “horizontal supervision”. Under the covenant, businesses promise to be compliant and to discuss any tax issues with the tax authorities in advance, and to voluntarily and proactively disclose all material tax risks and potential discussion points. In return, the tax authorities undertake to respond quickly to the businesses’ requests.

This scheme works well in Singapore as well as Netherlands. India can also adopt such a scheme in order to reduce tax evasion.

11.5. REGISTRATION THRESHOLD

The number of firms that have to be handled by the GST administration can be sharply reduced by setting a high turnover threshold. The revenue lost by setting a high threshold may be small compared to the saving of administration costs to the authorities and compliance costs to the taxpayer, because the potential tax base is commonly very strongly concentrated in the largest companies. Moreover, firms not registered for GST nevertheless face a non-zero effective rate of tax, because they cannot reclaim the ITC paid on inputs. Also to be factored into setting the threshold, however, is the potential distortion that any threshold creates in the competition between those above and below it; this will be eased by the possibility of voluntary registration, but it is by no means yet resolved whether the appropriate response to this distortion is to set the threshold lower than would otherwise be appropriate. It is in this background that the threshold limit is raised to Rs. 40 lakh turnover per annum in all states except the north- eastern states from 1st of April, 2019.

11.6. INCREASE IN BOTH LEGAL AND TECHNICAL AWARENESS

The biggest tax reform since Independence, the Goods & Services Tax (GST), has been a big challenge, especially for small and medium traders. The new indirect tax regime is good in one sense for the traders as it relieves them from the onerous task of filing too many papers, compliance with various taxes, interaction with department officials and also rescuing them from the decade-old clutches of inspectors. But on the other side, only 35 per cent of the trading community has computers, which creates a major compliance issue. Further, awareness about GST Law, Rules & Regulations among the trading community is poor and that creates a big challenge.

Since GST is an indirect tax regime, the final tax has to be paid by the consumer and undoubtedly traders are the only contact with the consumers. The major responsibility of collecting tax is devolved upon the traders and they have an important role to play for a successful GST tax regime. It is suggested that a nationwide awareness campaign should be launched by the government with the support of trade associations all over the country. Subsidy should be provided by the government to empower the traders with computerisation in order to ensure better compliance.

11.7. OTHER MEASURES TAKEN AROUND THE WORLD

Other measures that are taken around the world to control these frauds and curb the problem of tax evasion are:

11.7.1. REVERSE CHARGE MECHANISM

Making structural changes to the GST system can be effective in some cases. In order to deal with missing trader or carousel fraud, EU member states increasingly introduce the reverse charge mechanism in relation to domestic supplies of specific goods and tradable services. The reverse charge mechanism prevents fraudulent suppliers from receiving large sums of VAT from their customers and going missing before remitting the tax to the tax authorities. For the same reason, EU member states apply the reverse charge mechanism to domestic supplies in specific economic sectors plagued by low tax morale. Application of the reverse charge mechanism in specific sectors will have the effect that fraudsters move to other sectors, and large-scale application of the reverse charge mechanism has the effect of reducing the VAT system to a single-stage retail sales tax, which may give rise to other types of fraud in view of the fact that the standard VAT rates in the European Union vary between 15% and 27%.

11.7.2. CHAIN LIABILITY

Another way for the tax authorities to ensure that the appropriate amount of GST is collected from a chain of transactions, and to reduce collusion between businesses with the purpose of defrauding the system, is to hold parties within a chain of supplies jointly and severally liable for GST that has not been remitted by other parties in the sequence of supplies. Chain liability exists in many member states of the European Union, including the United Kingdom. The UK tax authorities (Her Majesty's Revenue and Customs, HMRC) apply this arrangement in the case of supplies of specific electronic goods that are particularly prone to missing-trader fraud if the customer "knew" or "had reasonable grounds to suspect" that the VAT payable on the supply, or on a preceding or a subsequent supply, would be unpaid.

The drawback of the chain liability is that innocent businesses may be unwittingly used by criminals and thus, although they lack deliberate intent, such innocent businesses bear the consequences of the fraud committed by others. Taken to extremes, such an approach may undermine the confidence that businesses have in the tax authorities with a consequent decline in incentives to comply with the rules (on the basis that they perceive themselves to be "damned if we do – damned if we don't comply").

The threat of such joint liability must, on the other hand, make businesses more circumspect about the businesses they contract with and would encourage them to be alert to warning signs that a particular contract involving supplies subject to GST is suspect. The approach is very much in the “big stick” category of incentives to encourage compliance and obviously may have rule-of-law implications if the protection of innocent businesses is inadequate.

11.7.3. GST ACCOUNTS

For maintaining the normal decrease and increase of ITC refunds and remittances associated with normal business transactions, whilst providing a buffer of security for the tax authorities, is to operate a GST account system. Under such a system, the GST paid by the customer is placed in a designated bank account held by the supplier. Suppliers can only use the balance of their blocked GST account for remitting ITC to the tax authorities or for paying ITC to their suppliers. The tax authorities do not refund ITC to businesses until they have checked the validity of their claim, which means that ITC is only refunded if the tax has been remitted first. It is obvious that this system slows down refunds and can cause some cascading. It is also obvious that large amounts of money are tied up in businesses’ blocked account, But with the help of this method, we can reduce tax evasion to some extent.

11.7.4. CERTIFIED SOFTWARE

Certified tax software can limit the risk of specific types of fraud and other irregularities, and it can provide certainty to honest businesses engaged in domestic and cross-border transactions.

Certified software, i.e. software systems developed by third parties or a business’s own tax accounting software, is currently being used on a voluntary basis in the US retail sales tax but it could also make VAT systems more robust. Under D-VAT certification, the tax authorities will develop a testing regime for the certification of the software. To be certified, the software would need to be comprehensive, and capable of determining the correct GST rate for every transaction and correctly calculating the ITC due; posting these amounts on the related invoices; linking each input or output to the correct GST return; completing the GST return accurately; and remitting the ITC due. Many existing accounting systems already have those features, but they are not certified as being “accurate”. In addition, the software will need to verify whether or not the system used by the contract partner is also certified.

The use of certified software in the United States is voluntary. However, in some instances, notably when an enterprise is heavily engaged in transactions deemed inherently prone to missing-trader fraud,

a jurisdiction might make certified software a mandatory condition of doing business. Although India is using GST network for this, it is not more updated. It can be improved to tackle all these problems.

11.7.5. VAT LOCATOR NUMBERS

On the basis of VAT Locator Number, the government can make any model for cross-checking of invoices. There are two models for the use of VAT Locator Numbers (VLNs): in Brazil, the use of VLNs is compulsory in relation to domestic or cross-border supplies of goods or services and, in Chile, the system is optional. Under the VLN system, customers cannot deduct input tax if the VAT is mentioned on an invoice without a valid VLN.

The first step of the VLN system is that the supplier creates an electronic file in XHTML (a “pro forma invoice”) which contains all necessary contract and tax information for a transaction. The seller signs the file digitally and transmits it electronically to the tax authorities. By doing so, the supplier is requesting authorisation for the use of the invoice in this form. After checking the XHTML file for accuracy and completeness, which is a fully automated process and is completed in a fraction of a second, the tax authorities assign a VLN (digital signature), which the supplier must attach, commonly in the form of a bar code, to the invoice, which the supplier then transmits to the customer. The customer seeks authorisation from the tax authorities, on the basis of the VLN, to deduct the VAT mentioned on the supplier’s invoice. If the information provided by the customer matches the information provided by the supplier, the tax authorities authorise the invoice for deduction purposes.

The VLN system, which is based on the same rationale underlying the stamp duty system in other jurisdictions, i.e. a document has no legal enforceability unless it is validly stamped, has resulted in significant revenue gains. Even greater efficacy is achieved in cross-border supplies if both the country of origin and that of destination apply the same system.

A far more sophisticated and secure version of VLN is real-time VAT, which, in some respects, is born out of the same insights as VLN. Whereas VLN digitally tags each supply and penalises businesses that pay VAT to their suppliers without having a valid VLN, real-time VAT digitally sequesters each payment that includes a VAT component, and automatically eliminates the possibility for suppliers to receive VAT from their customers and for customers to deduct any VAT that has not been remitted. Under real-time VAT, the system shifts the supplier’s VAT liability to the date on which he receives the price from his customer, and the customer’s right to deduct input tax shifts in tandem to the date on which he pays his suppliers through a secure banking system. The banking system is capable of

splitting off the VAT element in the customer's payment and (electronically) remitting the VAT to the tax authorities, which makes it necessary that all transactions are paid by means of electronic funds transfer (EFT) to the effect that the supplier's liability is automatically collected when the customer pays for the transaction. Under real-time VAT, suppliers only receive the VAT-exclusive price for their supplies. Through EFT, the tax authorities refund the deductible VAT immediately to the customer.

12. CONCLUSION

Tax evasion not only leads to leakage of government revenues, but also puts compliant taxpayers at a disadvantage, since they have to compete in a prejudiced business environment. GST will be always susceptible to tax evasion and fraud. Typically, instances of tax evasion encompass a wide range of malpractices such as trade invoicing, suppression of sales, misclassification of goods, undervaluation of goods, over-claiming of Input Tax Credit (ITC), under-reporting of sales, collection of taxes but not remitting with the exchequer, etc.

Owing to increased reports of tax evasion and consequent low GST collections, the tax authorities have to strive hard to build a robust structured mechanism to strengthen tax compliance. With the exponential growth of data and emerging reporting, the need for tools and techniques to detect, mitigate and tackle tax evasion is compelling. Various measures have been taken by the government in this regard, which include syncing GST registrations with PAN, invoice level reporting and matching, reconciliation of credits, generation of e-way bills etc. Some of the areas still need to be focused on like improvement in infrastructure of GSTN, precision in categorisation of goods and services, encouraging and incentivising diligent dealers through rewards, recognition and ratings, integration of GST database with income tax, customs and banking network to undertake a 360-degree analysis of the risk profile of tax payers, collaboration with private sector specialising in fraud analytics etc.

With the vision to make India a developed nation, improving technology in the taxation system can help achieve the desired results of a faster detection of tax evasion and easier tax compliance for both business and tax authorities. These technology tools and practices should be coupled with legislative measures to simplify tax laws including complex tariff structure, rationalise tax rates, make taxpayers aware and compliant and eventually mitigate tax evasion. Better tax compliance by tackling tax evasion would ultimately benefit not only the country but also honest tax payers, whose tax incidence is expected to come down.

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