GOODS AND SERVICES TAX (GST) REGIME IN INDIA

Development Pathways using Tax as a Leverage

Table of Contents

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1. Introduction

India implemented the Goods and Services Tax (GST) on July 1, 2017, which marked a substantial change in the nation's economic framework with the objective of achieving "One Nation, One Tax."[1] GST aimed to replace the complex and fragmented indirect tax structure with a unified and streamlined tax regime. Several key factors led to the implementation of GST in India.

1.1 Complexity of Previous Tax System

The pre-GST tax regime in India was characterized by a multitude of 17 indirect taxes levied by both the central and state governments. The central taxes included Central Excise Duty, Service Tax, and Central Sales Tax (CST), while the state taxes encompassed Value Added Tax (VAT), entry tax, luxury tax, and entertainment tax, among others. Each tax had its own set of regulations, rates, and compliance requirements, resulting in significant administrative complexities for businesses.[2]

1.2 Cascading Effect of Taxes

The cascading effect of taxes, where tax is levied on tax without any mechanism to claim credits for taxes paid on inputs, was a major drawback of the previous system. This led to an increase in the cost of goods and services, making them less competitive For instance, the cascading effect of taxes, where VAT was levied on a value that included excise duty, resulted in a tax-on-tax scenario, increasing the overall tax burden on goods and services. This fragmented structure created complexities and compliance burdens.[3] The GST system was meant to lower the cost of goods and services, therefore benefiting consumers all throughout the country.

1.3 Tax Evasion and Leakages

The fragmented tax system in India has led to tax evasion and leakage, with businesses often under-reporting sales, overstating expenses, or engaging in cash transactions. The lack of a unified system made it difficult to track and prevent such activities. The Ministry of Finance estimates that India loses approximately ₹2 lakh crore annually due to these activities.[4]

1.4 Market Inefficiency

India's federal structure, with each state having its own tax laws, created barriers to the free flow of goods and services across state borders. States imposed entry taxes on goods entering their territories, restricting free movement and causing inefficiencies.[5] Pre-GST, inter-state border tax checkpoints created bottlenecks in goods transport, making the logistics sector inefficient.[6] A study found that logistical costs in India accounted for 14% of the GDP, compared to 8-10% in other major economies, primarily due to inter-state barriers and multiple taxation.[7]

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[1] Goods and Services Tax Council. (n.d.). The GST saga. https://gstcouncil.gov.in/sites/default/files/The-gst-saga.pdf
[2] Government of India, Ministry of Finance. GST Day, PIB Release. Retrieved from https://static.pib.gov.in/WriteReadData/specificdocs/documents/2023/may/doc202351190701.pdf
[3] Centre for Budget and Governance Accountability. (2017). *Removing cascading effect of taxes: GST*. Retrieved from https://www.cbgaindia.org/wp-content/uploads/2017/08/Removing-Cascading-Effect-of-Taxes-GST.pd
[4] Ministry of Finance, Government of India, "Revenue Loss Due to Tax Evasion," 2016.
[5] World Bank. (2018). *Implementation of India's Goods and Services Tax: Design and International Comparison*. Retrieved from https://documents1.worldbank.org/curated/en/918831542619297197/pdf/GST-final-IDU.pdf
[6] *One Nation - One Tax: Goods and Services Tax*. Press Information Bureau. Retrieved from https://static.pib.gov.in/WriteReadData/specificdocs/documents/2023/may/doc202351190701.pdf
[7] Confederation of Indian Industry (CII), "Logistical Costs in India," 2017.

1.5 Revenue Efficiency

An important reason for the implementation of GST was to enhance tax compliance and minimise revenue leakage. GST was designed to improve revenue efficacy for both the central and state governments by expanding the tax base and implementing a seamless input tax credit.

1.6 Global Competitiveness

To enhance its global competitiveness, India needed a tax system that was in line with international best practices. According to the World Bank, the introduction of GST was expected to improve India's ranking in the Ease of Doing Business Index by simplifying tax compliance and reducing the overall tax burden on businesses.[8]

In response to the concerns, the Kelkar Task Force recommended a comprehensive Goods and Services Tax that was based on the VAT principle.[9] The objective of GST was to consolidate numerous central and state taxes, eliminate entry taxes, and establish a unified tax framework. The objective of this reform was to optimise the tax structure, mitigate economic inefficiencies, and foster a well-organized market environment. GST is a significant advancement in India's tax framework, as it offers a more unified, transparent, and efficient system.

The journey of GST will be the focus of this report, with an emphasis on its main features, achievements, and ongoing challenges and a way forward.

[8] World Bank, "Ease of Doing Business Report," 2018.
[9] National Academy of Customs, Indirect Taxes & Narcotics. FAQs on GST. https://nacin.gov.in/resources/file/downloads/569899280412e.pdf

2. GST Framework and Key Features

The Goods and Services Tax (GST) law in India establishes a comprehensive framework for simplifying the indirect tax structure, stimulating economic growth, and improving tax compliance. GST's fundamental features, including as its dual structure, destination-based taxes, input tax credit system, and computerised compliance methods, have altered the Indian tax environment.

While GST evolves in response to changes in the business climate and regulatory needs, the overall goal of creating a single national market remains critical to its implementation and effectiveness. The key Features of GST Framework include:

2.1 Regulatory Framework and Key Components of Goods and Services Tax (GST)

In India, the GST regulatory framework encompasses a diverse array of laws, rules, regulations, and administrative systems. The Central Goods and Services Tax Act of 2017 (CGST Act) is the primary legislation that regulates GST and is applicable to the in-state supply of goods and services. Also, in order to regulate intrastate commerce, each state has enacted its own State Goods and Services Tax Act (SGST Act). The GST Council, which is composed of representatives from the national and state administrations, provides the framework upon which both the CGST and SGST Acts are structured.

Inter-state supplies are regulated by specific statutes, including the Integrated Goods and Services Tax Act, 2017 (IGST Act), in addition to the CGST and SGST Acts. Applicable to union territories is the Union Territory Goods and Services Tax Act, 2017 (UTGST Act). India's GST regulatory framework is predicated on these statutes and the GST (Compensation to States) Act of 2017.

2.2 Destination-Based Taxation

GST in India is a destination-based tax, meaning the tax is collected by the state where the goods or services are consumed, rather than where they are produced. This is a significant shift from the origin-based taxation system, which often led to inefficiencies and tax cascading. Under GST, the tax burden shifts to the point of consumption. This helps in avoiding the cascading effect of taxes, promoting exports, and improving the balance of trade. Example: If goods are produced in Maharashtra and consumed in Karnataka, the GST revenue goes to Karnataka, the destination state.

2.3 Dual GST Model

India implemented a dual GST approach, in which the central and state governments both impose GST on a single tax base. This is designed to accommodate India's federal structure. This dual paradigm ensures that the national and state governments have separate but concurrent jurisdiction over the taxation of goods and services.

- **Central GST (CGST)**: Levied by the central government.
- **State GST (SGST)**: Levied by state governments.
- **Integrated GST (IGST)**: Levied on inter-state supplies and collected by the central government, later apportioned between the centre and states.

2.4 Subsummation of Taxes into Four-Tier Tax Structure

Under the previous indirect tax regime in India, the rate structure was highly distorted due to multiple taxes that contributed to significant complexity and inefficiencies. Different taxes and rates[10] were:

- **State taxes:** purchase tax (10-14.5%), luxury tax (3-20%), entertainment tax (15-50%), entry tax (0-12.5%), value-added tax (5-14.5%), and taxes on lottery, betting, and gambling (10-15 %).
- **Union taxes:** central excise duty (12.5%), countervailing duties (12.36%), service tax (15%), additional excise duty (5-10%), special additional duty of customs (4%), and central sales tax (2%).

GST regime has subsumed a multitude of central and state taxes, simplifying the tax structure, reducing the tax burden on consumers and minimising the cascading effect of taxes. GST in India is structured into a four-tier tax rate system to accommodate the varied socio-economic landscape. GST in India is structured into rate slabs of 0%, 5%, 12%, 18%, and 28% to balance taxation across essential and luxury items. Lesser common rates of 0.25% and 3% apply to specific goods.[11]

GST Rate	Categories with Examples
0%	Essential goods and services like unprocessed cereals, fresh vegetables, healthcare services
5%	Lower rate for essential items like edible oils, sugar, railways, packaged food items
12%	Standard rate for various goods like processed food, Ayurvedic medicines, business class air tickets
18%	Standard rate for most items like consumer electronics, industrial goods, restaurant services
28%	Luxury and demerit goods like luxury cars, aerated drinks, five-star hotel accommodations

Additionally, several items were exempted from GST and continue to be taxed separately. These include alcohol for human consumption, petroleum products: and electricity.

Under the GST framework, exports are treated as "zero-rated supplies." This means that while the exported goods or services are not subject to GST, the input taxes paid on such goods or services can be claimed as a refund.[12] These exemptions are aimed at boosting competitiveness and economic growth, creating an efficient tax environment for trade and industry.

2.5 Input Tax Credit (ITC)

One of the most critical features of GST is the seamless flow of input tax credits across the supply chain, which eliminates the cascading effect of taxes. ITC allows businesses to claim credit for the GST paid on purchases or inputs, which can be used to offset the GST liability on sales. Proper documentation and compliance with the GST laws are necessary to avail of ITC. This includes timely filing of returns and maintaining accurate records of purchases and sales. ITC encourages

[10] Finance Commission of India. (2015). *Fourteenth Finance Commission Report*.
[11] GST Council. (2017). *Goods rates booklet*. Retrieved from https://gstcouncil.gov.in/sites/default/files/goods-rates-booklet-03July2017.pdf

businesses to comply with GST regulations, thereby increasing transparency and boosting revenue collection.

2.6 Threshold Exemption

GST law provides a threshold exemption limit to ensure that small businesses are not burdened with tax compliance. Businesses with an annual turnover below ₹40 lakhs (₹20 lakhs for special category states) are exempt from GST registration and payment. This exemption reduces the compliance burden on small and medium enterprises (SMEs), allowing them to focus on growth and development. This provision aims to ease the compliance load on small businesses while ensuring that larger entities contribute fairly to the tax system.

2.7 Composition Scheme

To simplify GST compliance for small businesses, a composition scheme is provided under the GST law. Businesses with an annual turnover up to ₹1.5 crore can opt for the composition scheme. Lower tax rates under the composition scheme, such as 1% for manufacturers and traders and 5% for restaurant services. The composition scheme offers a simplified tax regime with lower tax rates and fewer compliance requirements, thus making it easier for small businesses to operate.

2.8 Compliance Mechanism

GST law has introduced a robust compliance mechanism to ensure transparency and accountability.

- **Reverse Charge Mechanism (RCM)** for procurement from unregistered dealers (URD). Initially, the recipient had to pay tax on supplies from unregistered suppliers. This requirement was later amended to remove the tax obligation from the recipient, except for specific cases such as cement in the real estate sector.
- **E-way Bill System:** The introduction of the e-way bill system in April 2018 was a major milestone. A GST impact study by EY-World Bank for the Ministry of Road Transportation and Highways found that removing commercial tax check-posts reduced trip time by around 17.45%. Exemptions for small intra-state consignments further streamlined logistics.
- **E-invoicing:** In June 2019, the GST Council implemented e-invoicing for B2B transactions. Initially applicable to businesses with a turnover above INR 500 crores, the threshold was gradually reduced to INR 20 crores by April 2022. This system has standardized invoicing, improved accuracy, and increased compliance
- **Quarterly Return Filing and Monthly Payment of Taxes (QRMP) scheme:** In 2021, The Central Board of Indirect Taxes & Customs introduced under GST started this scheme to help small taxpayers whose turnover is less than Rs.5 crores. The QRMP scheme allowed the taxpayers to file GSTR-3B on a quarterly basis and pay tax every month.

2.9 Anti-Profiteering Clause

To ensure that the benefits of GST are passed on to the end consumers, an anti-profiteering clause is included in the GST law to prevent businesses from unfairly increasing prices in the guise of GST implementation. The National Anti-Profiteering Authority (NAA) monitors compliance with these regulations and takes appropriate action against noncompliant businesses. The anti-profiteering provisions aim to safeguard consumers from unfair pricing practices while also ensuring that the advantages of GST are realised through lower costs and increased affordability.

2.10 Electronic Tax Filing and The GST Network (GSTN)

GST requires electronic filing of returns, payments, and compliances through the Goods and Services Tax Network (GSTN) website. GSTN provides a single IT infrastructure for national and state tax administrations, taxpayers, and stakeholders, making it easy to register online, file returns, match invoices, and perform other compliance tasks. It also integrates numerous GST procedures and stakeholders, increasing tax administration efficiency and effectiveness.

Businesses are required to file regular GST returns, detailing their sales, purchases, and the taxes collected and paid. The main returns are GSTR-1 (outward supplies), GSTR-2A/2B (inward supplies), and GSTR-3B (monthly summary). By automating operations like return filing, invoice matching, and tax payments, electronic tax filing enhances tax administration efficiency, minimizes taxpayer compliance requirements, and allows for faster refund and credit processing.

2.11 GST Council and Tax Administration

The GST Council, which consists of central and state government officials, is in charge of policy formulation, rate determination, and GST administration. It meets on a regular basis to address GST implementation issues, lobby for tax rate changes, and resolve disputes between the central government and the states. The GST Council respects the principles of cooperative federalism and consensual decision-making, ensuring that all stakeholders actively engage in the GST system.

To resolve the issue of dual control and jurisdiction over the GST taxpayer base and ensure a single interface under GST, the Council determined the following:[13]

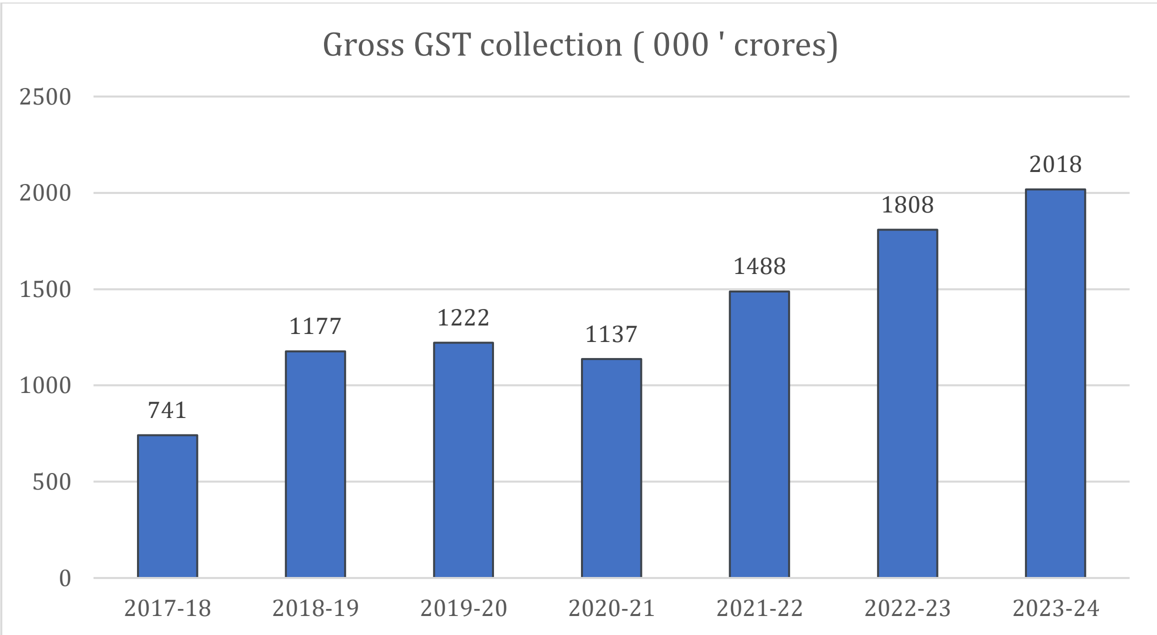
- Taxpayers with a turnover under ₹1.5 crore received 90% administrative authority from the State tax administration and 10% from the Central tax administration. • Taxpayers with a turnover beyond ₹1.5 crore received equal administrative control from both the Centre and the State.
- Flexibility in division: The Council can swap taxpayers between the Centre and States at regular periods.
- Both the Central and State tax administrations will have the authority to conduct intelligence-based enforcement operations throughout the value chain.

[13] https://gstcouncil.gov.in/sites/default/files/gst%20rates/Signed%20Minutes%20-%209th%20GST%20Council

3. GST Regime: The Impact

India's economic growth was hindered by a complex indirect tax structure, causing inefficiencies, increased compliance costs, and restricted market access. The introduction of GST, which reduced tax barriers, promoted interstate commerce and unified the national market, positively impacted economic growth by enhancing economic integration, facilitating seamless product and service movement across state borders, improving market access, and increasing business opportunities.

The GST streamlined tax compliance for businesses by establishing a unified tax rate structure, standardised tax procedures, and a singular online platform for tax filing and payment. The GSTN portal facilitated seamless communication with tax authorities, the filing of returns, and the claim of input tax credits by taxpayers. Consequently, tax compliance improved, resulting in increased revenue collection. The number of taxpayers increased from 60 lakh in 2017 to 1.40 crore in 2023, and over 114 crore returns were reported to have been filed as of June 2023.[14]

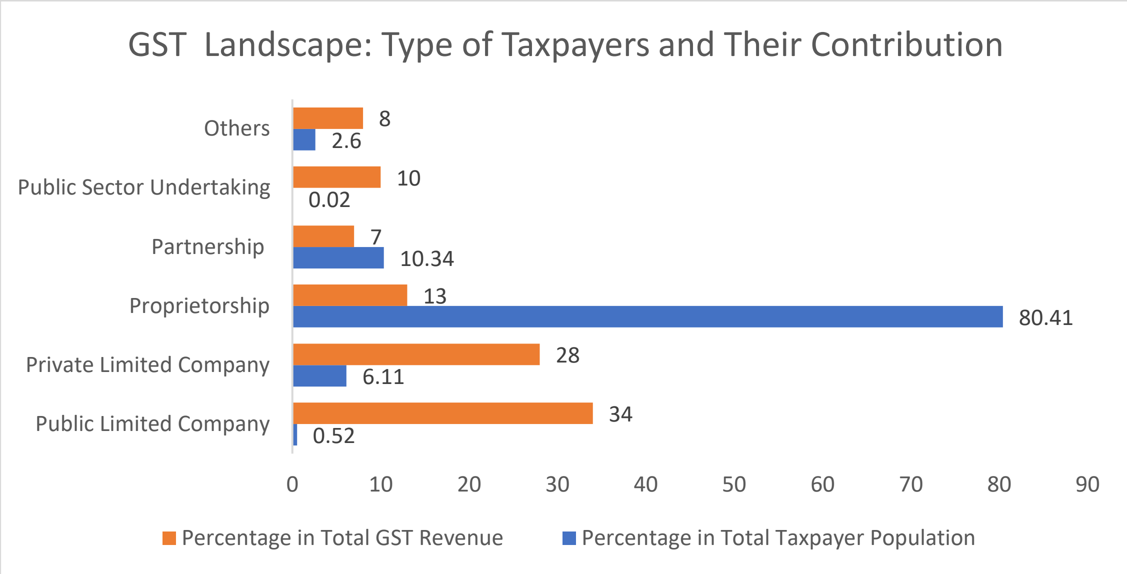


Source: GSTN (2023). A Statistical Report on Completion of 6 Years of GST

In the financial year 2023-24, gross GST collections reached ₹20.18 lakh crore, an 11.7% increase from the previous year. April 2024 saw a record-high gross GST collection of ₹2.10 lakh crore, a 12.4% year-on-year increase. Talking about the increased revenue of States, SGST revenue, including compensation released to states, in the post-GST period of 2017-18 to 2022-23, has achieved a buoyancy of 1.22. In contrast, the tax buoyancy of State revenues from subsumed taxes in the pre-GST four-year period of 2012-13 to 2015-16 was a mere 0.72.[15]

[14] Press Information Bureau. (April 2024). *Ministry of Finance.* Government of India. Retrieved from https://pib.gov.in/PressReleasePage.aspx?PRID=2016802

[15] Press Information Bureau. (February 2024). *Ministry of Finance* Government of India. Retrieved from https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2001151



Source: GSTN (2023). A Statistical Report on Completion of 6 Years of GST, Status as on June 30, 2023

The graph above depicts the distribution of various types of enterprises in terms of their proportion of the overall taxpayer population and contribution to total GST income in the economy. Proprietorships dominate the taxpayer landscape at 80.41%, demonstrating their popularity in entrepreneurial ventures. Despite their numerical dominance, they contribute a paltry 13% of GST revenue, highlighting their typically lesser scale in comparison to other company forms. In comparison, whereas public limited firms make up only 0.52% of the taxpayer base, they account for 34% of GST revenue, suggesting their greater operations and potentially higher turnover. Private limited companies, which account for 6.11% of taxpayers, contribute 28% of GST, indicating a high economic impact per entity. Partnerships and public sector undertakings are smaller sectors of taxpayers, yet they provide approximately 10% of GST revenue, demonstrating their specialised responsibilities in the economy. The data consequently reveals a diversified economic landscape in which various types of enterprises play varying roles in taxpayer representation and revenue production under the GST regime.[16]

According to the National Statistical Office's (NSO) second advance estimate, GST collections as a percentage of GDP reached 6.86% in the most recent fiscal year. This represents a slight increase from the 6.72% recorded in the 2022-23 fiscal year. Comparatively, in the 2018-19 fiscal year, the GST-GDP ratio was 6.23%.[17]

3.1 Improvement in Ease of Doing Business

GST significantly streamlined tax compliance, enhanced transparency, and reduced the administrative burden for businesses in India. GST has significantly improved India's ranking in the Ease of Doing Business index, from 130 in 2017 to 100 in 2018, and further improved to 63 as per World Bank estimates. It has also improved India's ranking in ease of paying taxes from 172 in 2017 to 115 in 2019.

[16] GSTN. (2023). *A Statistical Report on Completion of 6 Years of GST*. Retrieved from https://www.gstn.org/statistical-report-6-years-gst

[17] Centre for Monitoring Indian Economy. (2024, April 10). *GST collections and their economic impact.* https://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=20240410115442&msec=810

The GST implementation has simplified the compliance process, with the number of required forms reduced from 495 pre-GST to just 12 under GST. Businesses can register under GST through an online portal, and the requirement to file a single return has reduced the administrative burden. The digital nature of GST processes minimizes physical interactions with tax authorities, reducing corruption and errors.

3.2 Pervasive Impact on Businesses

Through technological integration and uniform processes, GST has not only simplified the tax structure but also improved India's business environment, benefiting a wide range of stakeholders and contributing to economic growth. GST has addressed legacy issues like the cascading effect and multi-fold compliances. Some of the key gains achieved have been:

- Elimination of Multiplicity and Cascading of Taxes thus reducing overall tax incidence
- The GST system has ensured quicker processing and disbursement of tax refunds, improving cash flow for businesses.
- The integration of technology in the GST framework has enhanced transparency, efficiency, and ease of compliance.
- Key initiatives like the e-waybill mechanism, e-invoicing, and auto-population of returns have notably reduced the compliance burden on taxpayers. By 31 March 2022, around 1.4 billion Invoice Reference Numbers (IRNs) were generated, and 464 crore e-waybills have been generated in the last six years.[18]

3.3 Benefits to MSMEs

Initially, the introduction of GST presented a challenge for businesses, especially smaller enterprises, in understanding and adhering to the diverse regulations. However, over time, the evolving GST framework has simplified processes and opened new opportunities for MSMEs.

- **Higher Exemption Thresholds:** Exemption threshold to ₹20 lakh and later to ₹40 lakh for goods, exempted many small businesses from GST registration and filing
- **Composition Scheme:** The composition scheme under GST allows small businesses to pay a fixed rate on their turnover instead of adhering to regular GST compliance. The thresholds are set at ₹1.5 crore for goods and ₹50 lakh for services, simplifying tax calculations and reducing paperwork for small businesses.
- **Trade Receivables e-Discounting System (TReDS):** This facilitated quicker access to finance for MSMEs and allowed MSMEs to discount their trade receivables from large corporates and CPSEs. With around 500 companies and 170 CPSEs participating, this system provides much-needed liquidity to MSMEs, helping them manage cash flows.
- **Quarterly Return Filing:** For businesses with an annual turnover of up to ₹5 crore, GST offers the option to file quarterly returns significantly easing the compliance burden,
- **GST portal for online filings and payments** further simplified the process, making it more accessible for MSME.

3.4 Improvement in Logistics and Efficiency

The introduction of the e-way bill system in April 2018 marked an important landmark in the journey of GST. An EY-World Bank study for the Ministry of Road Transportation and Highways found that removing commercial tax check-posts reduced trip time by around 17.45%.[19] To further streamline logistics, the government provided exemptions for small intra-state consignments from e-way bill compliance. The e-way bill system captured the transport details in

[18] Government of India. (n.d.). *E-Invoice System*. Goods and Services Tax Network. https://einvoice1.gst.gov.in/
[19] Ernst & Young. (n.d.). *GST transformation: The road ahead*. https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/tax/gst-compliance-technology/ey-gst-transformation-the-road-ahead.pdf

a fully automated mode, even allowing updates through mobile devices. GST has drastically improved logistics by ending long queues of trucks and goods carriers at highway toll plazas, facilitating smooth movement across states. According to a World Bank report from March 2018, logistics companies now report that trucks cover an additional 100-150 km per day, a 30% increase, thanks to GST.[20]

3.5 Cooperative Federalism

One of the most notable examples of cooperative federalism in India is the GST. In order to implement GST for the benefit of the country and its citizens, the Centre and States collaborated to surmount a variety of obstacles through peaceful consensus. In this system, the Centre and the States have worked in close harmony, sharing sovereignty in decisions regarding indirect taxation. Since the implementation of GST over six years ago, this collaborative endeavour has expanded, with nearly all GST decisions being reached through consensus. This spirit of cooperative federalism has been instrumental in the successful implementation and ongoing administration of GST in India.

3.6 Impact on Tax Rate

Significant savings for consumers have resulted from the gradual reduction of tax rates on essential and daily-use items. After the implementation of GST, a study conducted by the Finance Ministry indicated that consumers began to save a minimum of four percent on their household monthly expenses on an aggregate basis. As a result, consumers are now spending less on daily consumables such as cereals, edible oils, sugar, sweets, and munchies. The effective weighted average GST rate has consistently fallen since 2017. Initially, the Revenue Neutral Rate (RNR) was suggested to be 15.3 percent, but it was lower at 14.4 percent in 2017 at the time of the inception of GST. By 2019, this rate had further decreased to 11.6 percent.[21]

Items such as furniture, sanitary products, and various household essentials saw a drop from 28% to 18%. Other daily use items, including condiments and hair oil, were reduced from 18% to 12%. Basic necessities like certain food grains and medicines saw even more significant reductions, moving from 12% to 5%, and some essential items were exempted from GST altogether, dropping from 5% to nil.[22]

The reductions in GST rates have made essential items more affordable in India, reducing the financial burden on consumers. However, GST has also increased the tax rates on services, causing increased costs in sectors like finance, insurance, and telecommunications. Previously taxed services were subject to an 18% increase under GST, resulting in a significant financial burden.

[20] Press Information Bureau. (2023). *One Nation – One Tax Goods and Services tax* . Government of India. https://static.pib.gov.in/WriteReadData/specificdocs/documents/2023/may/doc202351190701.pdf
[21] Reserve Bank of India. (2023). *Debt: States' Medium-Term Fiscal Challenge* https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=19240
[22] Central Board of Indirect Taxes and Customs. (n.d.). *GST rates for goods and services*. Government of India. Retrieved from https://cbic-gst.gov.in/gst-goods-services-rates.html

4. Key Issues and Challenges in GST Regime

4.1 Multiple Tax Rates and classification issues

Keen (2013), argues that levying tax at multiple rates, especially lower rates on items predominantly consumed by low-income groups for equity reasons is an inefficient way.[23] Levying GST at four main rates, along with various cesses, leads to misclassification, complicates administration, and increases the compliance burden on businesses.

The Goods and Services Tax (GST) regime encounters a significant challenge due to the complexity of its classification system, which relies on the Harmonized System of Nomenclature (HSN) codes. The Indian HS Classification structure encompasses 21 sections, 99 chapters, approximately 1,244 headings, and 5,224 subheadings, covering a wide array of goods and services.[24] Multiple tax structures are easily prone to misclassification.

This extensive classification system also poses difficulties for businesses in accurately categorizing their products and services. The number of classifications makes it challenging to pinpoint the precise category for goods and services, leading to ambiguity and confusion. As a result, businesses often struggle to determine the correct HSN code, leading to errors in the application of Input Tax Credit (ITC) and tax liabilities as classifications play a key role in determining the tax rates. Incorrect classification can lead to underpayment or overpayment of taxes, creating financial implications for businesses and frequently resulting in disputes and litigation between businesses and tax authorities.

The GST Classification Debate - Paratha vs. Chapati

For twenty months, a dispute simmered over whether frozen parathas should be taxed at the same rate as chapatis. Both items are staple foods in India, yet they were subject to different GST rates. Chapatis, considered an essential item, were taxed at a lower rate of 5%, while parathas faced a higher 18% GST rate. This discrepancy led to significant confusion and contention among businesses and tax authorities.

The Karnataka Authority for Advance Rulings (AAR) ultimately ruled that parathas are distinct from chapatis due to differences in preparation and ingredients. This distinction justified the higher tax rate for parathas, according to the AAR's decision. This ruling emphasized on the complexities and challenges inherent in GST classification. Businesses dealing in food items must navigate a nuanced classification system that can lead to significant tax implications.

The "Paratha vs. Chapati" case exemplifies the challenges businesses face under the current GST regime's multiple tax rates and complex classification system. Simplifying the GST structure and reducing the number of tax rates could help alleviate these issues, ensuring more straightforward compliance and reducing the administrative burden on businesses.

Classification of products under GST requires considering various aspects such as common parlance, end-use, technical specifications, constituents, and ultimate consumer. Relying on just

[23] Keen, M. (2013). The anatomy of the VAT. *National Tax Journal, 66*(2), 423-446.
[24] Ministry of Corporate Affairs, Government of India. (n.d.). ITC HS Codes. Retrieved from https://www.mca.gov.in/XBRL/pdf/ITC_HS_codes.pdf

one aspect may lead to incorrect classification, making the determination of the right tax classification a complex process.

4.2 Inverted duty structure

The multiplicity of GST rates can lead to an inverted duty structure where input taxes claimed as credits exceed output taxes payable, resulting in refunds when input tax rates are higher than output tax rates. [25] For example, In the textile industry, synthetic fibre is subject to an 18% tax, filament at 12%, and cloth at 5%. Consequently, there is a substantial accumulation of input tax credits. Manufacturers are confronted with difficulties in issuing refunds on this account.

In the same vein, the housing sector imposes a 28% tax on the majority of construction inputs, while affordable housing units are subject to a compounded levy of 1% and 5%. If enterprises wish to claim input tax credits, the rates that apply are 5% and 12%, respectively. As a consequence of this discrepancy, businesses in these sectors experience financial strain and liquidity issues due to the substantial quantity of unutilized input tax credits.

4.3 Multiple registrations across the state for business - A logistical Challenge

Businesses with a pan-India presence face operational challenges. In order to comply with GST regulations, businesses that operate in multiple states are required to register separately in each state from which they conduct external supplies. Although the objective is to guarantee strong tax compliance and accountability in each state jurisdiction, this has unintentionally presented numerous obstacles for businesses.

Administrative Overhead: Maintaining multiple GST registrations imposes significant administrative burdens on businesses. Each registration requires distinct compliance records, documentation, and periodic filings, complicating the tax process and increasing resource allocation, especially for SMEs. This dual compliance necessitates filing multiple returns and managing input tax credits for both CGST and SGST, further adding to the paperwork.

Increased Compliance Costs: Multi-state registrations escalates compliance costs for businesses with a pan-India presence. Beyond the initial registration fees, ongoing compliance activities such as filing returns, managing audits, and addressing jurisdiction-specific queries entail additional financial outlays.

Complexity in Regulatory Adherence: Varying state regulations and procedural requirements further compound the challenges of multi-state GST registrations. Businesses must navigate divergent state-specific tax laws, notification updates, and compliance deadlines, leading to operational intricacies and potential compliance lapses.

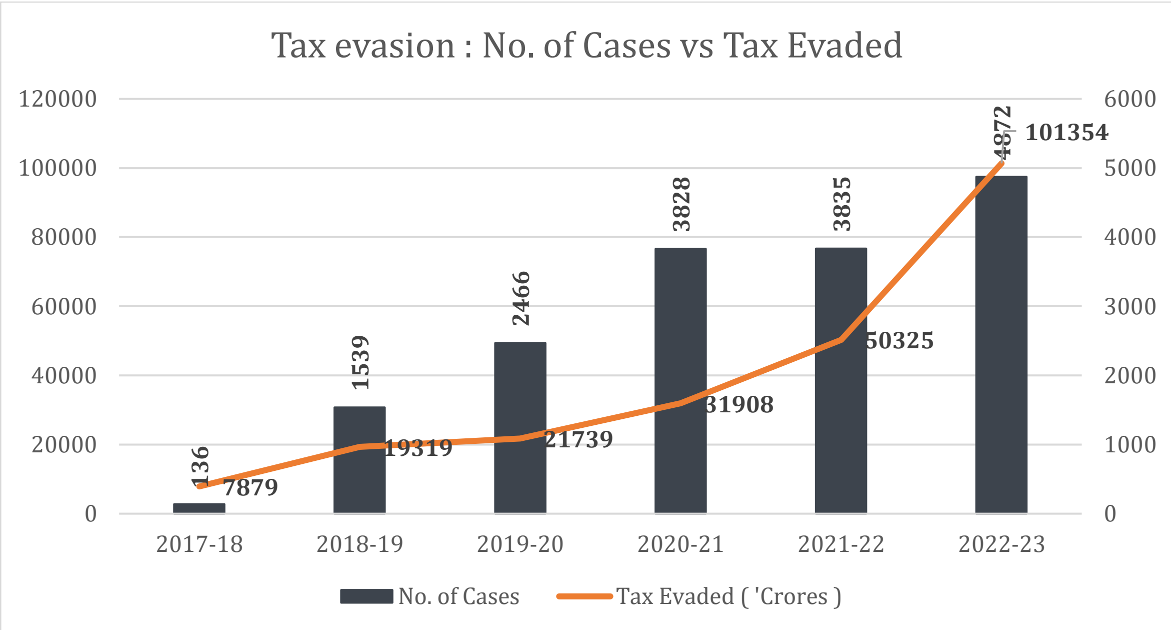
Challenges such as cumbersome registration processes, increased compliance costs, and regulatory intricacies hinder operational efficiency for businesses across multiple states, affecting uniformity and efficiency.

[25] Export Credit Guarantee Corporation of India. (n.d.). *Inverted Duty Structure Report*. Retrieved from https://main.ecgc.in/wp-content/themes/pcwebecgc/images/pcECGPagePDF/ResearchArticle/ECGC_Research_Inverted_Duty_Structure_Report.pdf

4.4 Tax Evasion and Frauds

Tax evasion and fraud are pervasive issues affecting many economies, causing substantial financial losses. One of GST's broader objectives in India was to reduce tax fraud, but this potential hasn't been fully realized due to various exploited loopholes.

During FY 2022-23, the Directorate General of GST Intelligence (DGGI) detected tax frauds totalling Rs. 1,01,354 crores, a significant 101% increase from the previous year. Over Rs. 20,000 crores of evaded tax were recovered, and the number of cases rose from 3,835 in FY 2021-22 to 4,872 in FY 2022-23. DGGI further detected evasion of around Rs 2.01 lakh crore in 2023-24 — an amount equal to almost 10% of the total GST collected during the financial year.



Source: Directorate General of GST Intelligence. (2023). Annual report 2022-23

Various methods uncovered for GST evasion include:

- Short payment of tax by undervaluing taxable goods and services (24 % cases accounting for 36 % GST evaded)
- Wrong availment of exemption notifications (19 % cases accounting for 43 % GST evaded)
- Non-payment of tax on the supply of taxable goods and services. (21 % cases accounting for 19 % GST evaded)
- Other methods: Incorrect or non-reversal of input tax credit, Tax collected but not paid to the government, Non-payment of tax under the reverse charge mechanism, Fraudulent input tax credit claims based on invoices from fake firms, and Fraudulent IGST refund claims on the export of goods.

Despite efforts to curb tax evasion under the GST regime, persistent fraud challenges continue to undermine the tax system's integrity and result in significant revenue losses for the government.

4.5 Non-Functional GST Appellate Tribunal (GSTAT)

A comprehensive dispute resolution system that efficiently resolves disputes while minimising litigation costs is a critical factor in the success of tax reforms. The primary reason for the significant increase in GST litigation over the past few years has been the frequent legal changes and ambiguous statutory provisions.[26] The absence of a functioning GST Appellate Tribunal (GSTAT) compounded these issues, burdening High Courts and causing delays, increased interest burdens, and cash flow challenges for taxpayers. As of August 2023, 14,227 appeals were pending under the GST Act.

Seven years after GST's inception, the government notified the establishment of the principal GSTAT bench in New Delhi and 31 state benches in May 2024, marking the beginning of the tribunal's operationalization.[27] Expected to be functional by January 2025, GSTAT would effectively streamline dispute resolution and enhance efficiency.

4.5 Input tax credit

The purpose of GST was to prevent the cascading effect of taxes and to guarantee the seamless movement of Input Tax Credit (ITC). Nevertheless, the reconciliation procedure mandated by GST continues to present substantial obstacles. This procedure necessitates that taxpayers reconcile the ITC claimed in GSTR-3B with the data that is automatically generated in GSTR-2A. Despite the GST Act's efforts to facilitate a smooth ITC process, discrepancies are not uncommon. The denial of ITC as a result of discrepancies between GSTR-3B and GSTR-2A is one of the most significant issues. These discrepancies are the result of a variety of factors, such as the non-uploading or erroneous filing of returns by suppliers, delays in claiming ITC within the prescribed time limit, and the incorrect classification of taxes, such as the IGST instead of CGST/SGST appearing in GSTR-2A. These issues result in the GST department issuing notices that disallow the ITC, further confounding compliance for taxpayers.[28]

Businesses are substantially impacted by the dual challenge of reconciling ITC claims and managing the administrative burden of addressing discrepancies, which complicates their overall compliance efforts and cash flow management.

4.6 Delays in Refund Processing

Businesses need to pay GST at the time of supply, which can strain their working capital, especially for those operating on thin margins. Processing delays in GST refunds, notably for exporters, lead to substantial cash flow issues. The liquidity of businesses is impacted by delayed refunds, which impede their ability to allocate working capital for operations. Timely refunds are essential for exporters to preserve their competitiveness in global markets. The requirement for extensive documentation to claim refunds and ITC adds to the administrative burden on exporters. Refund delays can contribute to the erosion of market position and profit margins.[29]

4.7 Logistics and E-Way Bill System Challenges

After the implementation of GST, all states have incorporated local taxes, such as Octroi and Entry Tax, into the GST. Toll taxes have been abolished in the Union Territory of J&K as of January 1, 2020. Nevertheless, the State of Himachal Pradesh continues to levie a carriage tax on specific

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[26] GST Council. (2023, February). *Newsletter February 2023*. Retrieved from https://gstcouncil.gov.in/sites/default/files/Newsletter-dynemic/Newsletter%20Feb,%202023_1.pdf

[27] Information Bureau. (2024, May 30). Establishment of GST Appellate Tribunal (GSTAT). PIB. Retrieved from https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2019749

[28] Sivadas, A. (2020). *Denial of ITC due to mismatch between GSTR 3B and 2A – An analysis*. The Institute of Cost Accountants of India. Retrieved from https://icmai.in/TaxationPortal/upload/IDT/Article_GST/189.pdf

[29] Deloitte. (2021). GST impact on key sectors: Analysis and insights. Deloitte. Retrieved from https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-gst-impact-on-key-sectors-noexp.pdf

products, such as cigarettes, that are brought into the state, in accordance with the Himachal Pradesh Taxation (On Certain Goods Carried by Road) Act, 1999 and the corresponding regulations. This levy is contrary to the fundamental objective of GST, which is "one nation, one tax," and is also erecting a fiscal impediment to free commerce.

The e-way bill system, which is intended to monitor the movement of products, has also encountered substantial implementation difficulties. Delays in the movement of products and disruptions to supply chains are the result of issues with the e-way bill system, including server downtime and system crashes. The compliance burden is exacerbated for logistics and transport companies by the requirement to generate e-way invoices for consignments exceeding a specific value.[30]

4.8 Disparities in State Compliance Requirements

Different states have varying compliance requirements, adding to the complexity of operating in multiple jurisdictions. Variations State-specific rules and procedures across states necessitate businesses to maintain state-specific compliance teams, increasing administrative costs. Businesses operating across multiple states face challenges in harmonizing compliance processes, leading to inefficiencies and higher compliance risks.[31]

4.9 GST and Illicit Markets

The presence of illicit markets poses significant challenges to the GST regime. Illicit markets, encompassing activities such as smuggling, counterfeit goods, and unreported cash transactions, undermine the tax base and disrupt fair competition. Illicit markets result in substantial revenue losses for the government as transactions in these markets typically go unreported, leading to tax evasion. Illicit goods often sell at lower prices due to the avoidance of taxes and regulatory costs, distorting market prices and harming legitimate businesses that comply with GST regulations. The OECD has highlighted that counterfeit and pirated goods can sell for 50-60% less than legitimate products, severely impacting fair market competition.[32]

4.10 GST and E-Commerce Sector

The e-commerce sector has unique compliance requirements under GST, particularly concerning TCS (Tax Collected at Source) and the treatment of returns and cancellations. E-commerce operators are required to collect TCS on the net value of taxable supplies, which adds to the compliance burden. Managing GST implications for returns and cancellations can be complex for e-commerce businesses.

4.11 Complexity of Returns

The GST compliance framework requires businesses to file multiple returns monthly, quarterly, and annually. The complexity of these returns, particularly the reconciliation of sales and purchase data in GSTR-1, GSTR-2, and GSTR-3B, has proven challenging for many taxpayers. Small and medium enterprises (SMEs) find it especially burdensome to maintain the necessary documentation and adhere to stringent deadlines.

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[30] Goods and Services Tax Network (GSTN). (2021). *E-way bill system*. Goods and Services Tax Network.
[31] Central Board of Indirect Taxes and Customs (CBIC). (n.d.). *State-specific GST compliance guidelines*. Central Board of Indirect Taxes and Customs. Retrieved from https://cbic-gst.gov.in/gst-compliance-guidelines.html
[32] OECD/EUIPO. (2016). *Trade in counterfeit and pirated goods: Mapping the economic impact*. OECD Publishing. https://doi.org/10.1787/9789264252653-en

5. Way Forward and Recommendations

The recommendations and way forward for the study are:

5.1 Simplification of Tax Rates/ Rationalisation of Tax Rates

- Implementing either a single GST rate structure or reducing the number of GST slabs and GST rate slabs/cesses would simplify compliance and tax administration, reduce confusion, improve efficiency, and promote voluntary compliance.
- Countries like Singapore and New Zealand have experienced streamlined tax administration and compliance, leading to higher compliance rates and revenue collections.[33]

5.2 Streamline Classification System

- Simplify the Harmonized System of Nomenclature (HSN) code structure/ Clarify tax rates for ambiguous product classification which will reduce compliance costs for businesses.[34]
- Ambiguities in product classification often led to disputes between taxpayers and tax authorities, resulting in administrative burdens and legal costs. Clear guidelines and consistent rulings can mitigate classification disputes and expedite dispute resolution.

5.3 Formalization of the Economy

- The tax-to-GDP ratio in OECD countries averaged 34.0% in 2022, markedly higher than India's 11.2%, largely attributable to India's substantial informal sector, which constitutes about 30% of its economy. [35]The informal sector, characterized by activities operating outside formal regulatory frameworks, contributes minimally to formal tax revenues due to challenges in tax collection from predominantly cash-based transactions.
- The informal are outside the GST net and neither can they take tax credits. They should be brought into a registration mechanism for taking tax credits and becoming competitive. By bringing previously unreported economic activities even with zero taxes into the formal sector with an increased tax base, improving the traceability of the supply chain, improving tax compliance, and reducing tax evasion.

5.4 Reduce Multi-State Registration Burden:

- Businesses that operate in multiple states are presently confronted with the challenge of obtaining and managing multiple GST registrations, which causes administrative complexities and compliance burdens.[36]

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[33] International Monetary Fund. (n.d.). *Goods and services tax design: Lessons from country experiences*. International Monetary Fund. Retrieved from https://www.imf.org/external/pubs/ft/gstdesign/index.htm

[34] National Institute of Public Finance and Policy (NIPFP). (2019). *GST in India: A reality check*. National Institute of Public Finance and Policy. Retrieved from https://www.nipfp.org.in/media/medialibrary/2019/05/WP_297_2019.pdf

[35] OECD. (2023). *Revenue Statistics 2023: Tax Revenue Buoyancy*. OECD Publishing. https://doi.org/10.1787/13287f4a-en; Patra, M. D., Behera, S. R., Behera, H. K., Banerjee, S., Padhi, I., & Sood, S. (n.d.). The shape of growth compatible fiscal consolidation. Reserve Bank of India. Retrieved from https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=43521

[36] World Bank Group. (2022). *Doing business 2022: Making a difference for entrepreneurs*. World Bank Group. Retrieved from https://www.doingbusiness.org/en/reports/global-reports/doing-business-2022

- Allowing for a single GST registration for businesses with pan-India operations will reduce administrative burdens and compliance costs for businesses operating across multiple states, facilitate business operations, and promote investments.

5.5 Improve ITC Mechanism

- The current ITC process is complex and time-consuming and streamlining this process can enhance efficiency and reduce disputes over mismatched credits.
- Simplifying ITC reconciliation can reduce administrative burdens and improve cash flow for businesses.[37]

5.7 Enhance Digital Infrastructure

- The GST portal has faced several technical challenges and glitches in the past and Improving its functionality and user interface can make compliance easier for taxpayers.
- Enhancing the digital infrastructure can streamline compliance processes, increase in transparency and reduce delays in refund processes.[38]

5.6 Enhance Anti-Evasion Measures

- To maintain the GST system's integrity and ensure equal tax treatment for all taxpayers, it's crucial to improve detection and prevention mechanisms, and increase penalties for non-compliance and fraudulent activities.
- Authority New Zealand and Australia have implemented robust anti-evasion measures, such as risk-based audits and data matching, which have resulted in improvements in tax compliance, revenue collection, and overall economic performance.[39]

5.8 Focus on Sector-Specific Reforms:

- Tailor GST policies to address the unique needs of different sectors such as agriculture, manufacturing, and services. Inverted duty structure affects key sectors like textiles, leather, and engineering goods where the higher taxation on raw materials compared to finished products undermines the competitiveness of Indian manufacturers
- Different sectors have unique requirements and challenges. Tailoring GST policies to these needs can enhance sectoral compliance and performance.[40]

5.9 Public Awareness Campaigns:

- The use of a variety of digital platforms and media can be employed to reach a broader audience and provide timely updates on GST policies and reforms. Regular updates and information dissemination through media can maintain stakeholders' engagement and inform them, thereby fostering compliance.
- Launch awareness campaigns to educate the public and businesses about the benefits and procedures of GST.

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[37] PricewaterhouseCoopers (PwC). (2021). *Improving input tax credit processes*. PricewaterhouseCoopers. Retrieved from https://www.pwc.com/gx/en/services/tax/improving-input-tax-credit-processes.html

[38] Goods and Services Tax Network (GSTN). (2021). *Enhancements to the GST Portal*. Goods and Services Tax Network. Retrieved from https://www.gstn.org/enhancements-to-the-gst-portal-2021

[39] Organisation for Economic Co-operation and Development (OECD). (2019). *Tackling fraud and evasion in VAT/GST*. OECD Publishing. Retrieved from https://www.oecd.org/tax/tackling-fraud-and-evasion-in-vat-gst.htm

[40] Confederation of Indian Industry (CII). (2022). *Sectoral impact of GST: A study*. Confederation of Indian Industry. Retrieved from https://www.cii.in/SectoralImpactofGST

- Use media and digital platforms to disseminate information and updates about GST policies and reforms.

5.10 Regular Stakeholder Consultations

- Conduct regular consultations with businesses to address GST-related issues.
- Implement feedback mechanisms to continuously improve the GST system[41]

The Indian GST regime faces numerous challenges, including complexity, high compliance burdens, technical errors, ITC mismatches, refund processing delays, and classification ambiguities. To overcome challenges and gaps, a collaborative effort among policymakers, businesses, and stakeholders is needed to streamline processes, improve IT infrastructure resilience, and ensure consistent implementation. The recommendations provide a framework for India's GST reform, aiming to improve efficiency, fairness, and fiscal sustainability. By implementing these recommendations and integrating evidence-based policy measures, India can fully realize the transformative potential of GST, promoting economic growth, and fiscal sustainability, and strengthening taxpayer trust in its GST reform journey.

[41] Ministry of Finance, Government of India. (2021). *Stakeholder engagement and feedback mechanisms*. Ministry of Finance, Government of India. Retrieved from https://www.finmin.nic.in/stakeholder-engagement-and-feedback-mechanisms-2021