GST Tax Reform Passes in India: Assessing the Impacts of the Historic Overhaul

Understanding the Compliance Challenges

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Introduction: Tax Revolution

After a decade-long journey, India's Goods and Services Tax (GST) finally has been implemented, effective July 1, 2017. The GST, which is essentially a destination/consumption-based tax, replaces one of the world's most complicated origin-based indirect tax systems. India's legacy system was plagued by a complex tangle of national (or "Centre") and state taxes, including a central excise duty, a service tax, a countervailing custom duty (CVD), and a special additional duty (SAD) as part of the customs tax structure, as well as value added tax (VAT) at the state level and state luxury taxes among numerous others. This complexity often resulted in a cascading effect of tax upon tax.

Indian Prime Minister Narendra Modi described the introduction of the GST as the largest overhaul of the country's tax system since India's founding as a country in 1947.[1] Indian Minister of Finance Arun Jaitley has called the GST "revolutionary."[2]

While few would argue against vanquishing the previous, headache-inducing tax system, the magnitude of change required to implement the GST will pose major changes to indirect tax functions in enterprises that operate in India. Prime Minister Modi's chief economic advisor said that GST will require "administrative change at the center and the states, lots of procedures, processes, new forms," and more.[3]

To date, the policies and processes companies will need to implement to adapt to the new tax system have received more attention than the technology capabilities needed to make compliance as effective and efficient as possible. This oversight should be rectified. GST's tax data management and tax reporting requirements are substantial. The tax-reporting and related technology adjustments GST requires may cause "chaos in the short term as the government gets the computer software up and running," according to *The Economic Times*, which also reports that the Indian government has so far trained more than 40,000 federal and state officers to manage the new compliance and reporting requirements.[4]

The sooner that tax functions understand these information needs, the better equipped they will be to determine if they have the right tax management technology in place to satisfy current and future compliance requirements. Sufficiently robust supporting technology will help tax functions quickly adapt to future GST changes and adjustments that are likely to materialize once GST has been implemented and unexpected problems arise.

By understanding the key components of the new system and what GST compliance challenges exist, corporate tax functions will be in a better position to refine, upgrade and/or replace their tax technology.

GST: From Origin to Destination

Under the previous origin-based system, roughly one dozen different types of indirect taxes could be applied to sales transactions.

At the Centre level, these taxes included a central sales tax (CST). However, while this tax was levied by the Centre, it was administered and collected by the states where the transaction parties were based. Other Centre taxes included surcharges and "cesses" (an old British term based on an abbreviation of "assess) on specific goods and services; a customs duty (CVD), a special additional duty of customs (SAD); and an excise duty (triggered on the manufacture of goods). At the state level, taxes included a VAT, entry tax, octroi tax, state-level surcharges and cesses, a purchase tax, a luxury tax, an entertainment tax and more.

The GST was designed, via a lengthy and contentious process (particularly within certain states), as a destination/consumption-based indirect tax that is triggered on the supply of goods and services. This marks a major departure from the previous scheme in which taxes were triggered by the manufacturing, sale or receipt of goods and services. More important, the GST mainly represents a single tax, although one with different components designed to increase the ease of administration. These components include:

- **Central Goods and Services Tax (CGST)**: the portion of the GST that goes to the Centre in the case of intra-state supply of goods or services;
- **State Goods and Services Tax (SGST)**: the portion of the GST that goes to the states in the case of intra-state supply of goods or services;

- **Integrated Goods and Services Tax (IGST)**: a component used—in lieu of CGST and SGST—in the case of inter-state supply of goods or services; and
- **Union Territory GST (UGST)**: This is applicable in lieu of SGST in those Union Territories that do not have a legislative assembly.

Although it is a broad-based tax, GST does not apply to all goods. For example, alcohol, petroleum products, the sale of completed land and buildings and tobacco, will remain under the former tax regime.

To illustrate how the GST will differ from the previous jumble of legacy indirect taxes, *Quartz India* recently published the useful example of a restaurant bill. Under the old approach, a diner's bill would contain four to five different taxes; under GST, the same bill now has two tax components: the CGST for the Centre and the SGST for the state.[5]

The GST features four levels of rates: 5 percent, 12 percent, 18 percent and 28 percent (which can increase to a maximum of 40 percent). There are also a number of exemptions, including essential commodities such as fruits and vegetables. The lowest rate will primarily be applied to essential supplies. The highest rate is expected to be applied on luxury items (e.g., automobiles).

The final rate schedule for goods and services was finalized and released at the end of June. Although draft rates were released about six weeks before the actual launch, notifying the publication of the final rates at the last moment gave companies very little time to update their tax rules, processes and supporting technology. Tax authorities also faced tight implementation deadlines. The government was given two months to file the returns for July and August 2017.

The GSTN portal (www.gstn.org) now functions as the primary technology interface for supporting massive numbers of GST registration, returns submissions, refund application, payments, IGST settlement and more. A quasi-government company, the GSTN portal will be jointly operated by Indian outsourcing and technology giant Infosys and nearly three dozen other services providers. The GSTN's site describes its mission in nine bullet points, which include: providing common and shared IT infrastructure and services to the Central and State Governments, Tax Payers and other stakeholders for implementation of the Goods & Services Tax (GST); and providing common Registration, Return and Payment services to the Tax payers.[6]

Despite these and other implementation challenges, the GST is expected by many to deliver substantial benefits over time. Most notably, Finance Minister Jaitley has estimated that GST will increase the country's economic growth by two percent; external economists and investment professionals place the growth impact in a wider range of .5 percent to more than two percent. Additionally, the GST should increase the ease of conducting business within India (especially across state borders) and between India-based companies and companies based in other countries. From a government perspective, "the GST is expected to improve tax compliance and draw more people into the tax net in a country where tax evasion is common. It will also make India more attractive for foreign investors by simplifying rules for a huge and increasingly attractive market."[7]

Other government benefits of a more well-defined, uniform tax system include greater tax transparency and less corruption. Ideally, the new system will also provide potentially significant benefits to tax functions and companies. The simplification of tax structures should eventually ease the compliance burden and lower compliance costs.

Some of these benefits have begun to materialize. A Malaysian international trade official recently projected an increase in his country's trade with India due to GST, and foreign ownership of Indian bonds has notably increased since the Indian Parliament approved the constitutional amendment that paved the way for GST in August 2016.[8]

Compliance Challenges Lurk

Malaysia knows a thing or two about GST benefits and challenges. In 2015, the country implemented a new GST with two rates, which replaced its previous sales and service tax regimes. As is the case in India, Malaysia's tax reform played out via a lengthy (11 years) and contentious process. And while Malaysia's GST marked an effort to simplify a complex system, it was met with "plenty of confusion and controversy." Updating and replacing tax technology figured prominently among the early implementation and compliance challenges that Malaysian companies and their tax functions faced following the launch of its GST in April 2015.[9]

Companies doing business in India will confront a unique set of GST-related challenges, although tax data management and tax technology challenges will figure prominently among these issues, which include:

- **Complexity**: Although the new system is designed to reduce complexity, it will take time for companies to adjust to the large number of new rates as well as the rules that determine which rates apply. Ironically, an overhaul designed to simplify a sprawling tax compliance challenge will initially give rise to some compliance confusion.
- **Timing**: Companies have very little time to adjust their tax management and reporting processes and supporting technology systems prior to GST's go-live date. The government's decision to hold off publication of specific rates (i.e., a list of which goods will be taxed at the four different rate levels) until the last minute caused tax and IT functions to scramble to update their systems to reflect the new rates.
- **Technology**: Nearly all of the GST-related guidance published by tax, accounting and consulting firms to date, emphasizes that companies should evaluate the degree to which their existing tax technology and accounting systems possess the breadth, flexibility and speed necessary to support the transition to GST, as well as GST compliance moving forward. Technology marks a pivotal success factor on the administration side as well. Much is riding on the newly created GSTN portal, which also may pose technology and compliance challenges to companies.

A number of other, still unknown challenges no doubt will materialize. It is a safe bet that additional legislative and regulatory adjustments will be needed once the new indirect tax system is in place.

Be Prepared: Tax Technology Considerations

Given the uncertainties and challenges surrounding GST implementation, corporate tax functions should be prepared to manage tax data as effectively and efficiently as possible. GST compliance will be difficult enough without rushing to track down tax data via highly manual and error-prone processes.

Recent guidance from Big 4 firms emphasizes the central role that tax technology plays in an effective GST compliance program. Deloitte identifies "systems design changes for GST compliance" as a key component of an effective approach.[10] EY indicates that GST will "stimulate the need to relook at internal organization and IT systems."[11]

While tax functions no longer have enough time to implement new tax technology prior to the onset of GST implementation this year, tax managers and executives should monitor how and where their existing tax technology falls short in supporting GST compliance processes. Understanding these shortcomings will lead to more informed decision-making on future upgrades and investments in new tax technology.

For example, tax functions will want to carefully track any data-security issues that crop up in their existing IT systems. This is prudent because GST implementation may create heightened and/or new information security risks "as a result of the aggregation of data from multiple sources," according to *The Economic Times* CIO publication.[12]

Based on current GST compliance and reporting requirements, it is clear that the following core tax technology capabilities will prove highly useful in supporting the tax function's GST-related activities:

1. **Unification**: This process harmonizes data from disparate sources for tax purposes. All relevant data is brought together in one place, at the appropriately granular level of detail. This funneling activity imports key information from enterprise resource planning (ERP), other finance and accounting, sales and marketing applications, and payroll and legal systems, among others, into a single, unified platform.

2. **Validation**: Once all the data has been gathered, this process determines how it fits into tax processes and whether any data needs to be reconciled in light of recent business changes before this information is used for subsequent tax processing. This activity also includes real-time validation that the data reflects the most up-to-date financial results, which is of particular concern at a quarter-end and year-end financial closing periods.

3. **Enrichment**: At this point, the data is converted from financial reporting into tax-ready formats, enriched by global tax content and consolidated by the prevailing accounting standards and currency. This process of readying the financial data for tax processing is typically automated, although it may in some cases require expert input. These activities create a central source of "tax-ready" data that can be leveraged across all tax functions and processes within the tax lifecycle.

4. **Access**: Once the tax calculations have concluded, the data is retained to satisfy all global data retention requirements and to provide an audit trail when necessary. This approach reduces audit exposure and related risks, while keeping the enriched data accessible for a wide range of analyses.

Conclusion: Global Lessons

Given the increasing demand for federal tax reform in a growing number of countries around the world, India's hard-earned and long-awaited transition to GST will be closely watched.

"Lessons learned in India's transition to the common GST will be important to both the United States and the European Union," writes Gavin Ekins, a research economist with the Tax Foundation. "If India's gamble turns out to be a boom to the Indian economy, the West may have to consider similar changes."[13]

Endnotes

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