

## Disastrous way to improve GST compliance

Praveen William | Updated on October 24, 2019 Published on October 24, 2019

### **The move to restrict input tax credit for non-filing of GSTR-1 is too harsh and could be legally challenged**

The 37th GST Council meeting held on September 20, 2019, was widely lauded for numerous business-friendly measures, which have significantly boosted trade confidence. The meeting also noticeably occurred in the backdrop of plateauing rates of compliance and frauds involving fake invoicing.

The recent Comptroller Auditor General (CAG) audit report highlighted that non-filing of Form GSTR-1 was an especially critical issue. This is because supplies declared in GSTR-1 provided the Income-Tax department invoice-level details to verify the turnover declared in GSTR-3B, which is merely a summary return.

Aiming to incentivise compliance and to check fraud, the GST Council suggested “imposition of restrictions on availment of input tax credit” where supplies had not been declared in the relevant return filed by the vendor. The industry was, therefore, left guessing as to exactly what restriction would be put in place.

This aspect has been made clear by the issuance of a recent notification whereby the amount of input tax credit pertaining to undeclared supplies has been capped at 20 per cent of credit pertaining to declared supplies.

Curiously, this restriction was first to be introduced in the new GST return mechanism (set to be introduced from April 2020). It, however, seems that the government is seeking a ‘trial run’ of the credit cap as it has also been applied through an amendment to the existing GST return (GSTR1/GSTR-3B) mechanism.

#### **Effect of credit cap**

<b>Total credit available pre-amendment</b>	<b>Credit pertaining to declared supplies</b>	<b>Credit pertaining to undeclared supplies</b>	<b>Credit cap (20% of credit of declared supplies)</b>	<b>Total credit that may be availed of post amendment</b>	<b>Credit deferred</b>
100	90	10	18	100	0
100	80	20	16	96	4
100	70	30	14	84	16
100	60	40	12	72	28
100	50	50	10	60	40

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Let's dive into this a bit deeper. To illustrate the financial implications of the credit cap, the possible scenarios in the credit pool are shown in the Table.

Deferment of the credit (which otherwise is available for utilisation) will need to be compensated through cash payment of output tax resulting in unnecessary blockage of working capital and further cascading of costs in the value chain.

Setting aside the financial impact of the credit cap, the parameters for 'matching' too are extremely uncertain. A few of the potential issues arising from this include:

**Documentary and data-entry errors:** This can relate to cases where a wrong invoice number or date has been reported by the supplier. Would minor clerical errors, such as the above, lead to credit being treated as 'unmatched' credit?

**Incorrect GSTIN is entered by the supplier:** In this case, the actual recipient of the supply loses out on credit despite having paid GST, along with value of supplies to the supplier

**Incorrect tax amount is entered by the supplier:** In such a case, it is unclear whether the entire credit would be disallowed as 'unmatched' or only 'unmatched' to the extent of discrepancy

**For suppliers with turnover below ₹1.5 crore, GSTR-1 is to be filed quarterly:** Here, the question is whether the credit claimed by the assessee is to be considered undeclared supply and 'unmatched' even though the supplier is legally liable to disclose the supply on a quarterly basis

**Time horizon for such 'matching exercise':** Here again the question is whether this activity is intended to be an annual exercise at the time of assessment as in the VAT regime or is it intended to be a recurring monthly compliance to be performed along with the filing of GSTR-3B?

The unanswered question that looms over the entire exercise is whether the imposition of harsh consequences on the recipient, for default of the supplier, is legal in the first instance and is it in a way penalising compliant assesseees?

The government's insertion of the restriction into the rules, rather than the act per se, may itself invite further legal challenges.

As a policy measure, the restriction implies greater compliance cost for large businesses and potential loss of credit.

This may involve a gradual shift of procurement from small business vendors out of fear of default. This may have undesirable consequences in the current economic scenario, wherein the government is actively seeking to provide a boost to the MSME/SME sector.

While there is no doubt that stricter compliance and circumventing fraud is absolutely necessary, there are reasons to believe that restriction of credit may be a drastic measure, which will have greater drawbacks than benefits.

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It is desirable that the government, in its endeavour to build trust, evolves robust technological solutions for matching of credit and engage in greater outreach for improving compliance.

A holistic solution would work better than a 'fatal' cure.

The writer is Partner, Indirect Tax, KPMG in India. Chartered accountants Sandip Jain and Aditya Venkataraman contributed to this article