

Consequences of GST: Indian Perspective

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ABSTRACT

India has traditionally been a cash intensive economy. According to an estimate, about **78 per cent** of all consumer payments in India are effected in cash. It was, therefore, obvious that currency squeeze during the demonetization period would have had some adverse impact on economic activity, although such impact was expected to be transient. In order to mitigate the adverse impact on the common man as also on economic activity, a series of measures were undertaken, keeping in view the feedback received from various quarters.

The Government of India announced the demonetization of all Rs 500 and Rs 1,000 all over the India. The government claimed that the action would stop the shadow (process of people making, selling, and buying things) and crack down on the use of illegal and (make fake money or goods) cash to fund illegal activity and terrorism. The sudden nature of the announcement and the lengthy cash shortages in the weeks that followed has created significant disruption throughout the (process of people making, selling, and buying things), threatening money-based output. The move was heavily criticized as poorly planned and unfair, and was met with protests, lawsuits, and strikes.

The purpose of this paper is to describe the changes that are happening during the demonetization and its consequences in India after the implementation.

Keywords: demonetization, reverse change, forward hikes

I. INTRODUCTION

1.1. Background

In November 2009, the Government released the discussion document, *GST: Accounting for land and other high-value assets*, which proposed a number of changes to the GST Act that would address certain GST base risks and improve the operation of the GST system more generally. The main risk to the tax base identified in the discussion document was “phoenix” fraud schemes, typically between associated entities, that involve Inland Revenue refunding GST to one party with no corresponding payment being made by the vendor because the vendor deliberately winds up their business before making payment.

The discussion document recommended a domestic reverse charge. However, most submitters expressed a preference for zero-rating as it would give rise to fewer compliance costs. That is the option that has now been adopted since, under this mechanism, the accounting obligations of the parties would in most situations remain virtually unchanged from the previous legislation.

II. GROWTH

The growth of gross value added (GVA) is expected to have been impacted primarily by the liquidity shock, i.e., limited access to currency as a medium of exchange for effecting transactions in the economy. This impact is

expected to have worked through two channels: **(a)** decline in demand due to shortage of cash to make payments, mostly on discretionary spending; and **(b)** disruption in production activity due to man hours lost as some workers, especially those in the unorganized sector who get their wages paid in cash, experienced temporary loss of work. The construction sector and some of the labor-intensive manufacturing sectors such as textiles, leather, gems and jewellery and the transportation sector engage casual/migrant laborers extensively. The loss of wage income for workers is also expected to have caused a drag on consumption demand.

The wealth effect is another channel through which demonetization could have impacted economic activity. However, the precise estimate of currency that returned to the banking system is not yet available as the reconciliation process is still on. Hence, the adverse wealth effect on account of SBNs not returning to the banking system could be assessed only after the reconciliation exercise is complete.

III. CONSEQUENCES OF INCORRECT GST TREATMENT

In some situations, the GST treatment of the transaction elected by the supplier may be found to be incorrect. The consequences of this will depend on whether the mistake is discovered before or after settlement.

IV. CORRECTION OF GST TREATMENT BEFORE SETTLEMENT

For a supply to be zero-rated, the conditions for zero-rating in section 11(1)(mb) must be satisfied at the time of settlement. Since the time of supply may occur before a transaction is settled, the supplier will need to determine whether the supply should be standard-rated or zero-rated at that earlier time. As discussed earlier, this determination will usually be made on the basis of the written statement provided by the purchaser.

Before settlement the parties may become aware that the GST treatment applied to the transaction thus far is not correct.

For example, on signing the sale and purchase agreement the purchaser may have informed the supplier that they will be registered at the time of settlement. The supplier zero rates the transaction as a result. Before settlement, the purchaser may decide to nominate a third person to settle the transaction. The nominated person indicates that they will not be registered at the time of settlement.

V. CORRECTION OF GST TREATMENT AFTER SETTLEMENT

In some situations the correct GST treatment may be unknown until after the transaction has been settled. The consequences of incorrectly standard-rating or incorrectly zero-rating the supply are set out below.

VI. NEW RULES OF APPORTIONMENT

For GST purposes, the amount of an input tax deduction that can be claimed by a GST-registered purchaser for acquired goods and services should relate to the taxable use of the goods and services.

This is achieved by allowing GST-registered persons to claim a full input tax deduction for GST paid on goods and services acquired for the principal purpose of making taxable supplies.

If the goods and services acquired for the principal purpose of making taxable supplies are used partly or entirely for another purpose – for example, for private and exempt purposes (non-taxable purposes), the GST Act treats the non-taxable use of goods and services as a taxable supply by the registered person, and output tax is charged accordingly.

Conversely, goods and services acquired principally for a non-taxable purpose (for which the GST-registered person is not entitled to an input tax deduction) could be partly or entirely used to make taxable supplies. In these circumstances, the GST Act allows a deduction to reflect that taxable use.

VII. SELF ACCOUNTING

The other development is the reported spurt in deposits in Jan Dhan accounts. As these accounts mostly belong to persons with low incomes, and often showed a near-zero balance, it suggests that these deposits may be black income being distributed among many agents. We have heard of benami titles to property, could we have just witnessed the emergence of benami deposits? Could the facility of allowing deposits of up to Rs.2.5 lakh without attracting income tax have unwittingly acted as a conduit to the laundering of black money?

Accounts have also come of gold sales rising. How can this be possible when high-denomination notes, which as we shall see constitute the overwhelming part of total currency in circulation, are no longer legal tender? We are told that this is made possible by pre-dating sales. Of course, where stock movement is verifiable this would be difficult. But it does speak of many loopholes that have been suggested as means of sabotaging the intent of the demonetisation. Yet more exist. We have actual statements made by party bosses in Tamil Nadu that they have distributed old notes to their workers before a by-election to come. So, in Uttar Pradesh where elections are due only in 2017, there is no reason why money cannot be distributed right away, a form of advance payment. One would expect that the Rs.4,500 limit on the exchange of notes is just the right magnitude in the context.

VIII. PRINCIPLES OF TACKLING BLACK MONEY

The first principle is that remove the systemic pain that leads to creation of black money in the first place. Blame lies with the tax department. Black money is nothing but money generated in legitimate transactions which are hidden from government so as to avoid paying the transaction cost (usually tax) in the legitimate economy this is usually done by using physical cash. This cash thereafter must be processed to convert into consumption or investment. Black economy refers to various activities, transactions etc. that help process this physical cash, create returns on this cash, facilitate consumption using this cash etc. The second principle has two parts. First, not all cash transactions are necessarily black money transaction. They become black money transactions only if they are hidden from the legitimate economy. Thus, a shopkeeper who does not give receipt but declares the sale (it's only hypothetical) does not create black money. Conversely, a shopkeeper who gives a receipt but discloses other receipt book to the tax authorities (happens all the time) creates black money transaction. Second, the black money must at some time or other be plugged into legitimate economy. Thus, it cannot be done using user created currency that cannot be exchanged with local currency. So it depends on legal tender. It means somewhere down the chain there must exist a person for whom part of this black money is legal cash income which he can use for his own consumption in legitimate channels. Usually, this is the construction worker, or other poorest of the poor who will give certain services and his income will remain under the



government radar. It can also be illegal traders in gold or diamonds etc. who can convert this into precious items that have quasi legal tender status. The third insight is that black economy is continuously fed by parts of white economy that go underground. Quite a few people who do not want to promote black money contribute to it. They are either coerced say developer forcing buyer to pay him in cash or government officer seeking bribes in cash. Therefore, preventing white money from becoming black the starting point. The recommendations of Report titled Measures to tackle Black Money in India and Black economy depends on black money financiers. These are money lenders earning like 2% per month on their investments for financing the activities in black money friendly sectors. Film financing, construction financing, retailers, dance bars, alcohol, etc. These financiers also need enforcement mechanism to ensure their money is safe. Naturally they ally with criminal elements. Al Capone, the famous Chicago mobster, was previously an enforcer but later a financier.

IX. CONCLUSION

The sudden withdrawal of 86 percent of currency (in terms of value) from the (process of people making, selling, and buying things) will not reduce people's dependency on cash in the near term, bank deposit levels will benefit in a "more meaningful fashion" once the (cash transactions that aren't taxed or watched by the government) is brought into the formal (process of people making, selling, and buying things) over the next few years. People will have no choice except to deposit their cash in banks so that all the unaccounted money has supposed to be deposited in banking system. The decision of demonitising higher (religious group/category of paper money) notes was never-before-seen and people are still nervous/eager about government move in upcoming days, so they have left with no choice except to declare their unaccounted money either by depositing in to a formal banking system or investing in any (related to managing money) part/area. Definitely the demonetization of 500 and 1000 rupee notes will improve/increase Banking part/area as well as other (related to managing money) parts/areas.

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