GST Challenges

Case - I loss to the exporter

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If X purchases and sells goods in the same month

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- In a particular month, X buys yarn and pays Rs.1050 to the yarn supplier.
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- Domestic Trade - Rs.1000 for the price of the yarn and Rs.50 for the GST at 5 per cent and X claims Rs.50 as the Input Tax Credit (ITC).
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- Then X manufactures fabric and sells it in the domestic market at a price of Rs.1260.
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- Rs.1200 for the cost of the fabric and Rs.60 for the GST, which he will pay at 5 per cent to the government.
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- Export trade - X also buys yarn to make fabrics for exports and pays Rs.300 for the price of the yarn and Rs.15 for the GST at 5 per cent.
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- When the yarn supplier deposits Rs.15 as GST and claims the ITC of this.
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- X makes fabrics and exports to the US at a price of Rs.400.
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- X's total turnover for the month is Rs.1600 (Domestic turnover of Rs.1200+Export turnover of Rs.400).
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- X earned a total ITC of Rs.65 (Rs.50+Rs.15).
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- X would use Rs.60 to pay her GST liability on domestic sales.
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- The net ITC available to her would be Rs.5 (Rs.65-Rs.60).
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- So the refund as per the formula would be Rs.1.25 (5*400/1,600).
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- X has paid Rs.15 as GST but gets back only Rs.1.25, a loss of Rs.13.75.
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*Assume X is Riain the chart

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Case 1

Ria's business	Value of yarn purchased (₹)	GST @5%	Value of fabric (₹)	GST on the output @5% (₹)	ITC available (₹)
Domestic	1,000	50	1,200	60	–
Exports	300	15	400	0	–
Total	–	**65**	**1,600**	**60**	**5 (65-60)**

Refund on exports: **₹1.25 (5*400/1600)**

GST actually paid on inputs for exports: **₹15** | Loss to the exporter: **₹13.75**

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Case – II gain to the exporter

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If X buys inputs in a particular month, but sells output in other months.

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- Yarn suppliers buy cotton in bulk during October-December and make/sell yarn rest of year, X may buy yarn in bulk for use rest of the year.
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- In such cases refund on exports would always be higher than the GST paid.
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*Assume X is Ria in the chart

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Case 2

Ria's business	Value of yarn purchased (₹)	GST @5%	Value of fabric (₹)	GST on the output @5% (₹)	ITC available (₹)
Domestic	1,000	50	200	10	–
Exports	200	10	1,000	0	–
Total	–	**60**	**1,200**	**10**	**50**

Refund on exports: **₹41.6 (50*1000/1200)**

GST actually paid on inputs for exports: **₹10** | Excess refund: **₹31.6**

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What are the complications in the GST calculation formula?

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- **Differing Refunds-**The zero rating of exports under the GST law implies that the Government would not charge the GST on the transactions leading to exports.
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- Even though the law agrees to zero rating of exports, the refund rules provide no guarantee that an exporter would get the refund that equals the amount of the GST paid.
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- The GST rules the refund would equal the total ITC available on a firm's account multiplied by the ratio of export turnover and the total turnover.
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- The export turnover and not the actual GST paid is the criteria for calculation of refund.
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- This means most firms would not get the GST paid on inputs as the refund.
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- Few firms would get less, while smart ones may use the system to get more money.
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- Refund rules allow differing refunds on the same GST amount paid.
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- For example, a firm buying yarn and exporting fabric will get less refund than the firm which buys yarn but exports shirts where prices are higher than the fabrics.
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- **Compliance with International standard** - The refund formula also fails to meet the requirement of the WTO law on subsidy.
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- Agreement on Subsidy and Countervailing Measures implies that any refund that exceeds the taxes paid on inputs consumed in the production of the exported product (making reasonable allowance for waste) would constitute an export subsidy.
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- The current formula deviates from the above principle and is susceptible to challenges at the WTO.
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How this issue can be addressed?

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- A separate accounting of the domestic transactions and the transactions leading to exports is needed in the GST system.
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- Domestic transactions like buying inputs for production of the export product would need to use the Export Invoices instead of the Normal Invoices.
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- This is required to identify the GST paid on transactions leading to exports.
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- Refund rules/formula needs a review to allow the refund of the amount that equals the GST paid on transactions leading to exports.
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- The Government has announced the introduction of the e-wallet system from April 2018 to ensure zero-rating of exports and resolve working capital blockage.
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- Maintenance of a separate account for export-related transactions and review of the refund formula would help in creating a transparent and WTO compatible refund scheme and e-Wallet.
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Source: Business line

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