

Anti-Profiteering in GST-

Necessity or Paradox

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A. Introduction & Need of Anti-Profiteering Law

We are going to witness biggest indirect tax reform in the history of independent India. However, global trends suggest implementation of Goods and Service Tax or Comprehensive VAT on Goods & Services lead to inflationary conditions in short to medium term economy. Our county being highly price sensitive market, necessarily requires checking whether implementation of new taxation regime will lead to inflationary conditions or vice versa.

Since GST Council has already declared different slab rates to be adopted in GST and the government has declared that mapping of Goods and Services will be on the basis of existing effective industry rate. It is amply clear on the part of the government, that it is not looking to have higher revenue from GST by charging higher rate of tax on any goods or services. However, effect of increase in tax base, reduced grey economy, and increased GDP will certainly add to the revenue kitty.

Now question arises, why increased inflation be there despite the fact that effective tax rate on all products will be more or less at par with existing rates. It is because the effective rate of tax at the consumer level gets changed immediately at the time of implementation, whereas industry takes time to pass on benefit(s) accrues to it to the consumer level because of many reasons such as unawareness about benefits available, lack of clarity on interpretational issues etc. At times it may be intentional in monopolistic market whereby industry wants to increase its profit by maintaining its selling price and pocketing whole of the benefits.

The same situation arose at the time of implementation of VAT in India. Many industries parked gains accrued to them on account of implementation of Value Added Taxation system and maintained prices till the time they were virtually certain about the final impact of VAT on overall profitability. After implementation of VAT, Comptroller and Auditor General of India conducted a national study on 'Implementation of Value added Tax in India' and released

Study Report named 'Lessons for transition to Goods and Services Tax' in June 2010. Relevant extracts from the report are as under:

“Impact of VAT on prices:

2.43 The white paper was sanguine that implementation of VAT will bring down the prices of goods due to rationalization of tax rates and abolition of cascading tax effects in the legacy systems. But there was no system to monitor this impact and ensure that the benefits were indeed being passed on to the common man.

*2.44 We selected a basket of goods and checked the records of 13 manufacturers in a state in three initial months of implementation of VAT, to check its impact on prices. **We found that manufacturers did not reduce the maximum retail prices (MRP) after introduction of VAT though there was substantial reduction of tax rates.** The benefit of Rs. 40 Crore which should have been passed on to the consumer was consumed by the manufacturer and the dealers across the VAT chain. The dealers have undoubtedly enriched themselves at the cost of the common man.”*

History, as observed by CAG, will repeat again if no legal deterrent is there. Let us understand this proposition with an illustration in case of a Trader who purchased goods from a manufacturer:

Cost Sheet in Existing Tax Regime:

Description	Amount (INR)
Purchase Price of Goods (A)	1,00,000
Excise Duty on Inputs @ 12.50% (B)	12,500
Value Added Tax @ 5.50%	6,188
Total Purchase Price	1,18,688
Operational Exp. (Business Consumables & Services) (C)	1,000
Tax on Operational/ Indirect Exp. (D)	150
Total Cash Outflow	1,19,838
Sales Price for the dealer (E)	1,25,000
Output Tax (VAT @ 5.50%)	6,875
Total Cost to Consumer	1,31,875
Profit of Dealer (E – A – B – C – D)	11,350
Total tax which govt. has received (CG + SG)	19,525

Cost Sheet in GST Regime (If consumer prices don't change):

Description	Amount (INR)
Purchase Price of Goods (A)	1,00,000

GST	18,000
Total Purchase Price	1,18,000
Operational Exp. (Business Consumables & Services) (B)	1,000
Tax on Operational/ Indirect Exp.	180
Total Cash Outflow	1,19,180
Sales Price for the dealer (C)	1,25,000
GST	22,500
Total Cost to Consumer	1,47,500
Profit of Dealer (C – A – B)	24000
Total tax which govt. has received (CG + SG)	22,500

It is evident from above illustration, that if the prices of the products are not adjusted for the benefits accrued to the supplier, the consumers are going to pay higher price for goods and services and situation will lead to inflationary conditions. In the given case by implementation of GST the dealer is getting benefit of excise duty on goods and VAT/ Service Tax on operational expenses, which he should ideally pass on to the consumer. In the illustration cited above (which is in line with study report of CAG), the dealer has not passed on any benefit to the consumer which results in increased cost to consumer and profits of the dealer increased to more than double. This is example of profiteering by dealer due to change in taxation regime and has to be regulated in new indirect tax regime.

B. Legal Provisions for Anti Profiteering in CGST Act & Analysis thereof

Sec. 171 of the CGST Act;

“1. Any reduction in rate of tax on any supply of goods or services or the benefit of input tax credit shall be passed on to the recipient by way of commensurate reduction in prices.”

“2. The Central Government may, on recommendations of the Council, by notification, constitute an Authority, or empower an existing Authority constituted under any law for the time being in force, to examine whether input tax credits availed by any registered person or the reduction in the tax rate have actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.”

“3. The Authority referred to in sub-section (2) shall exercise such powers and discharge such functions as may be prescribed”

The first part Sec. 171(1) casts responsibility to pass on benefit of GST to recipient for following two aspects:

a. For any rate reduction in new tax regime:

As regards passing of benefit due to rate reduction, in case of supplies exclusive of tax there should not be a big challenge, since reduction in tax rate will directly be evidenced by invoices and the recipient will get benefit of the rate reduction. However, in case where contract of supplies is inclusive of taxes, this provision will cast responsibility on the supplier to reduce the price due to reduction in rate of taxes. For example, FMCG items which are normally sold on MRP basis or some other fixed prices by retailers, if there is any reduction in rate of tax it has to be passed on to the ultimate recipient. Accordingly, there shall be need to revise MRP or other prices fixed for such supplies.

b. For any benefit of Input tax Credit:

As regards passing of benefit due to better credit chain, it is going to affect almost all industries. In most places, be it service sector, manufacturing, trading or any specific industry, all are going to get advantage of better flow of Input Tax Credit. So the expectation of the provisions are commensurate reduction in prices of supplies. If we apply this principal in plain reading to the above illustration, we can reframe it as under:

Cost Sheet in GST Regime (If no one profiteer itself, on account of taxes):

Description	Amount (INR)
Purchase Price of Goods (A)	1,00,000
GST	18,000
Total Purchase Price	1,18,000
Operational Exp. (Business Consumables & Services) (B)	1,000
Tax on Operational/ Indirect Exp.	180
Total Cash Outflow	1,19,180
Sales Price [Cost (A+B) + plus existing margin] (C)	1,12,350
GST	20,223
Total Cost to Consumer	1,32,573
Profit of Dealer (C - A - B)	11,350
Total tax which govt. has received (CG + SG)	20,223

Comparison of three scenarios:

Description	Existing Provisions	GST (Without adjusting prices)	GST (Without Profiteering)
Cost to Consumer	1,31,875	1,47,500	1,32,573
Profit of Dealer	11,350	24000	11,350
Total Govt. Taxes	19,525	22,500	20,223

After going through the comparison of three scenarios, it is evident that adequate reduction in prices is essential for success of biggest indirect tax reform of the country. Accordingly it is need of the hour that industry suomoto reduces prices of goods and services. However, if it doesn't do so, then legal provisions are there in place to take care of such situations. Introduction of this measure is required to curb the practice of pocketing the tax benefit, rather than passing it on to the ultimate consumer by way of real reduction in the price of supplies. That is why, despite lot of agitation from industry after release of revised model law in November 2016, the government maintained same provision in the CGST Bill too, which has already passed from both houses of the parliament, and has taken the shape of law of the land after signing from hon'ble President of India.

As of now Sec. 171 it is an enabling provision only in the enactment, which is to be followed by Rules made by central government. No draft rules have been put in public domain by the government to be discussed by the Industry for implementation & preparation on this provision.

C. International Practices & Indian Context

India is not the first country which is heading towards Comprehensive GST (VAT) with Anti-profiteering measure. Many countries like Canada, New Zealand, Australia and Malaysia etc. have witnessed such measure while adopting Goods and Service Tax regime. Broadly, as per overseas experience, the impact of Anti-profiteering law was troublesome for the industry. Accordingly, India needs to learn from experiences of others while imposing anti profiteering measures in the Indian Economy.

Recently, Malaysia had adopted Goods and Services Tax in 2015, whereby they brought Anti Profiteering provisions for GST through their existing legislation called 'Price Control and Anti-profiteering Act 2011'. Amendment in the existing legislation was done through amendment act of 2014 whereby main operating provisions read as under:

"Sec. 15(1A) The mechanism to determine that profit is unreasonably high referred to in subsection (1) includes the Minister determining a certain period

during which there shall be no increase in the net profit margin of any goods or services.”

Further, Part II and Part III of Schedule to Price Control and Anti Profiteering (Mechanism to Determine Unreasonably High Profit) (Net Profit Margin) Regulations 2014 had prescribed mechanism to calculate net profit margin pre-and post Goods and Service Tax regime respectively. After that both had to be compared in order to make sure that there is no increase in net profit margin post GST implementation.

In Australia too, the Anti Profiteering measures were effected through amendment in existing legislation called “Australia competition and Consumer Act 2010”. Whereby Sec. 44ZZT had been added to impose restriction as regard to anti profiteering on class of Goods and services.

Further, In India, The Competition Act, 2002 was enacted with following objectives as mentioned in section 18:

- Elimination of Practices having adverse effect on competition
- Protection of interest of consumers
- Promotion and sustainability of competition
- Ensuring Freedom of trade among participants in the Indian Markets

Competition Commission of India (CCI) was duly constituted under the Competition Act to take due care of above mentioned objectives of the said enactment. Objectives of the CCI is more or less at par with objectives of proposed Anti Profiteering law. Looking to the experience of handling similar nature of task, CCI may be entrusted as the competent authority under Sec. 171 of the CGST Act.

D. Applicability of Anti Profiteering provisions on Credit lying in Stock.

Sec. 140 of CGST Act allows taking credit of eligible duties in respect of inputs held in Stock and inputs contained in semi-finished or finished goods held in stock, for certain classes of registered persons where such credit was not reflected in returns of respective law. By allowing carry forward of such credit to the registered person the government has ensured that such stock, when supplied in GST regime, will not suffer double burden of taxes and relevant benefit are passed to the registered person. Now question arises whether this benefit of credit has to be passed on to the consumer by way of reduction in price of supplies or not?

As discussed above, Sec. 171 is clearly applicable in two circumstances only. Firstly being reduction in rate of tax, which is not the case. Secondly being

benefit of Input Tax Credit. The definition of 'Input Tax Credit' as provided in Sec. 2(63) read with Sec. 2(62) means CGST, SGST, UTGST & IGST charged on any supply of goods or services. The credit of eligible (old) taxes on stock carried forward in GST regime cannot be said to be input tax credit in the GST enactment. Therefore, it seems Sec. 171 will not cover such kind of credit and accordingly, benefit of such credit need not be passed on to the end customer.

It may be noted that in the Revised Model GST Law released in Nov 2016, there was a specific provision for passing on of such credit to the recipient, but the same is not there in CGST Act. It appears that government has withdrawn this condition in the final law, looking to the demand of industry and computational challenges, difficulties arising in verification that whether such credit has been passed on to the recipient or not.

However, if the credit of tax paid in stock is claimed under proviso to Sec. 140(3) read with Rule 1(3) of Draft Transitional Rules (i.e. where registered person doesn't have the document evidencing payment of tax or duty), it is necessary to pass on benefit of such credit to recipient by way of reduction in prices.

E. Issues & Challenges

1. Computational Mechanism

- a. Practically it is very difficult to establish one to one correlation between ITC on inward supplies and Tax payable on outward supplies. So ultimately it comes on margins or prices of supply. How the margins and prices are to be checked is a subjective matter. There may be various ways like:
 - Profit on product in absolute terms.
 - Profit percentage on Cost of product.
 - Profit percentage on Sale Price.
- b. Further apart from benefits in terms of better credit chain, the business organisations are going to incur huge cost for implementation of GST on account of installation of new IT systems, restructuring of operations, redesigning of SOP's, Compliances cost etc. Whether, the organisation can set off its gains in terms of better credit flow with its increased cost, before passing of the same to consumer. In other words, if rules prescribe for maintaining of margins, whether the same is to be maintained on Cost of Product level, Gross Margin level, Operational Profit Level or Net Profit Level.

Industry should represent before government with its rationale and demands. However, one thing which has to be ensured that rules

should be detailed enough so that there will be no discretion available to any authority which leads to corrupt practices.

2. Determination of Price.

One fact needs to be noted that prices and margins are not solely dependent on taxes. Rather they are only a component of price like any other components. Price determination depends on many factors such as:

- Internal factors:
 - Cost of raw material or other component
 - Predetermined objectives (Higher profit or higher revenue)
 - Image of the Seller (Goodwill)
 - Life cycle of the product (Initial level may be less priced or even free sample after that there may be increase in price)
 - Credit period offered.
 - Promotional activities (Heavy advertisement/ promotional exp.)
- External factors:
 - Competition
 - Consumers (price sensitivity & purchasing power of buyer)
 - Government Control
 - Economic Condition (Recession)
 - Supply Chain (Longer the chain, higher would be the price)

Price determination of any product is most complex and continuous process, cycle of which depends on nature of product. If prices or margins are being freezed, on account of Anti Profiteering Measures, then it may lead to disastrous situation in many industries. Further, at times there may be strategic pricing for some products which the companies don't want to share with anyone including tax authorities.

3. Constitutional Challenges

a. Right to Free trade

Article 301 of our Constitution provides freedom of trade, commerce and intercourse throughout the territory of India. However, article 302 authorises parliament to Impose reasonable restrictions. Anti-Profitteering provisions or restriction on profits of trade of all goods or services may be treated as violation of fundamental right of freedom of Trade, hence may be subject to judicial review.

b. Implication on State Tax/ Assessees

It is pertinent to note that power to constitute authority u/s 171 is with central government only. Article 302 also authorises Parliament to impose such restrictions, whereas there are stringent conditions for state legislatures to impose such kind of restrictions under Article 304.

In such a scenario implementation of Anti Profiteering measures in respect of

- State Tax (i.e. SGST) administered by any Govt. OR
- Registered Persons, under State Jurisdiction for all taxes may be subjected to judicial review.

F. Conclusion

From consumers' point of view Anti Profiteering Provision is necessarily required to be there so as to ensure deserving benefit is passed on to them. At the same time, looking at the issues and challenges before industry and the efforts involved in reworking of cost sheet and re-fixing of prices, it is advisable that

- a) A reasonable bandwidth for margin variation should be prescribed, say for example variation upto 10% of existing margins. If variation remains within such bandwidth, no registered person should face any penal consequences u/s 171 of the CGST Act.
- b) A threshold limit for turnover of taxable supplies may be prescribed, below which provision of sec. 171 shall not apply.
- c) Further for above threshold limit, detailed rules, covering all aspects including computation mechanism, documents to be maintained etc, should be prescribed so that no discretionary power is left in hands of any authority which in turn can cause harassment of the tax payer.

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- Indirect Taxes Committee